

ECONOMIC SURVEY OF ASIA AND THE FAR EAST 1971



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Beginning with the ninth volume (1958/59), the *Economic Bulletin for Asia and the Far East* has been issued quarterly, in March, June, September and December. The March issue is the annual *Economic Survey of Asia and the Far East*, the June and September issues contain articles and notes on subjects related to the Asian economy, and the December issue features special studies and reports relating to economic development and planning.

The Bulletin is prepared by the secretariat of the Economic Commission for Asia and the Far East and is published entirely on the responsibility of that secretariat. The designations employed in this publication do not imply the expression of any opinion whatsoever on the part of the secretariat of the United Nations concerning the legal status of any country or territory or of its authorities, or concerning the delimitation of its frontiers.

Since the 1957 issue, the *Economic Survey of Asia and the Far East* has, in addition to a review of the current situation of the region, contained a study or studies of some major aspect(s) or problem(s) of Asian economy, as specified below:

- 1957: Postwar problems of economic development
- 1958: Review of postwar industrialization
- 1959: Foreign trade of ECAFE primary exporting countries
- 1960: Public finance in the postwar period
- 1961: Economic growth of ECAFE countries
- 1962: Asia's trade with western Europe
- 1963: Import substitution and export diversification
- 1964: Economic development and the role of the agricultural sector
- 1965: Economic development and human resources
- 1966: Aspects of the finance of development
- 1967: Policies and planning for export
- 1968: Economic problems of export-dependent countries Implications of economic control and liberalization
- 1969: Strategies for agricultural development Intra-regional trade as a growth strategy
- 1970: The role of foreign private investment in economic development and co-operation in the ECAFE region. Problems and prospects of the ECAFE region in the Second Development Decade
- 1971: Economic growth and social justice. Economic growth and employment. Economic growth and income distribution

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PREFACE

The present *Survey* is the twenty-fifth in a series of reports prepared annually by the secretariat of the Economic Commission for Asia and the Far East. A major object of these *Surveys*, and of the quarterly *Economic Bulletin*, is the analysis of recent economic developments in the countries of Asia and the Far East, and of international developments that affect them. Particular attention is paid to the analysis of economic policy and policy issues.

Since 1957, in addition to review and analysis of developments in individual countries of the region, it has been the practice of these annual *Surveys* to examine specific problems concerning the economies of the region in order to study long-term trends and their implications for national policies. In keeping with this practice, Part One of the present *Survey* contains three separate studies on social justice, employment and income distribution in the ECAFE region. Part Two, in addition to individual current surveys of twenty-six countries of the region, contains two special studies, the first on recent economic development and emerging policy issues in the ECAFE region in 1970/71 and the second on the international monetary situation.

The *Survey* is published on the sole responsibility of the ECAFE secretariat; the views expressed should not be attributed to the Commission or to the Governments of member countries.

Bangkok, March 1972

EXPLANATORY NOTE

The term "ECAFE region" is used in the present issue of the *Survey* to include Afghanistan, Australia, the British Solomon Islands, Brunei, Burma, Ceylon, China, Fiji, Hong Kong, India, Indonesia, Iran, Japan, the Khmer Republic, Laos, Malaysia, Mongolia, Nauru, Nepal, New Zealand, Pakistan, Papua New Guinea, the Philippines, the Republic of Korea, the Republic of Viet-Nam, Singapore, Thailand, Tonga and Western Samoa. The term "developing ECAFE region" excludes Australia, Japan and New Zealand.

Reference to "tons" indicates metric tons, and to "dollars", United States dollars, unless otherwise stated.

The term "billion" signifies a thousand million.

Three dots (...) indicate that data are not available or are not separately reported.

A dash (—) indicates that the amount is nil or negligible.

A blank in a table indicates that the item is not applicable.

A hyphen (-) between dates representing years, e.g. 1950-1960, is used to signify the full period involved, including the beginning and end years.

A stroke (/) indicates a crop year, fiscal year or plan year, e.g. 1970/71.

The plan years of the ECAFE countries coincide with their fiscal years as given in the table below.

In respect of information given, the countries listed below have generally been included, subject to limitation of data.

<i>Country</i>	<i>Fiscal year</i>	<i>Currency and abbreviation</i>	<i>Official rate of exchange for one United States dollar as of March 1972 except as otherwise indicated</i>
Afghanistan	21 March to 20 March	Afghani (Af)	45.00
Australia	July to June	Australian dollar (A\$)	0.84
British Solomon Islands . .	January to December	Australian dollar (A\$)	0.84
Brunei	January to December	Brunei dollar (B\$)	2.84
Burma	October to September	Kyat (K)	5.46
Ceylon	October to September	Rupee (Rs)	5.97 ^a
China	January to December	Yuan	2.00 ^b
Fiji	January to December	Fijian dollar (F\$)	0.87
Hong Kong	April to March	Hong Kong dollar (HK\$)	5.58
India	April to March	Rupee (Rs)	7.28 ^a
Indonesia	January to December	Rupiah (Rp)	^c
Iran	21 March to 20 March	Rial	75.75
Japan	April to March	Yen (¥)	304.20
Khmer Republic	January to December	Riel (Ri)	120.00
Laos	July to June	Kip (Kp)	600.00
Malaysia	January to December	Malaysian dollar (M\$)	2.84
Mongolia	January to December	Tugrik	...
Nauru	July to June	Australian dollar (A\$)	0.84
Nepal	16 July to 15 July	Rupee (Rs)	10.13
New Zealand	April to March	New Zealand dollar (NZ\$)	0.84
Pakistan	July to June	Rupee (Rs)	4.79 ^a
Papua New Guinea	July to June	Australian dollar (A\$)	0.84
Philippines	July to June	Peso (P)	6.43 ^a
<u>Republic of Korea</u>	January to December	~~Won~~	387.00
Republic of Viet-Nam	January to December	Piastre (Pr)	118.00
Singapore	April to March since 1969/70	Singapore dollar (S\$)	2.84
Thailand	October to September	Baht	21.00 ^a
Tonga	July to June	Tongan dollar (T\$)	0.84
Western Samoa	January to December	Samoa tala (WS\$)	1.40

^a Selling rate.

^b Basic rate according to *United Nations Statistical Yearbook*.

^c Exchange rates are 374, for *Major export rate*, and 415 for *Major import rate* and *Other import rate*.

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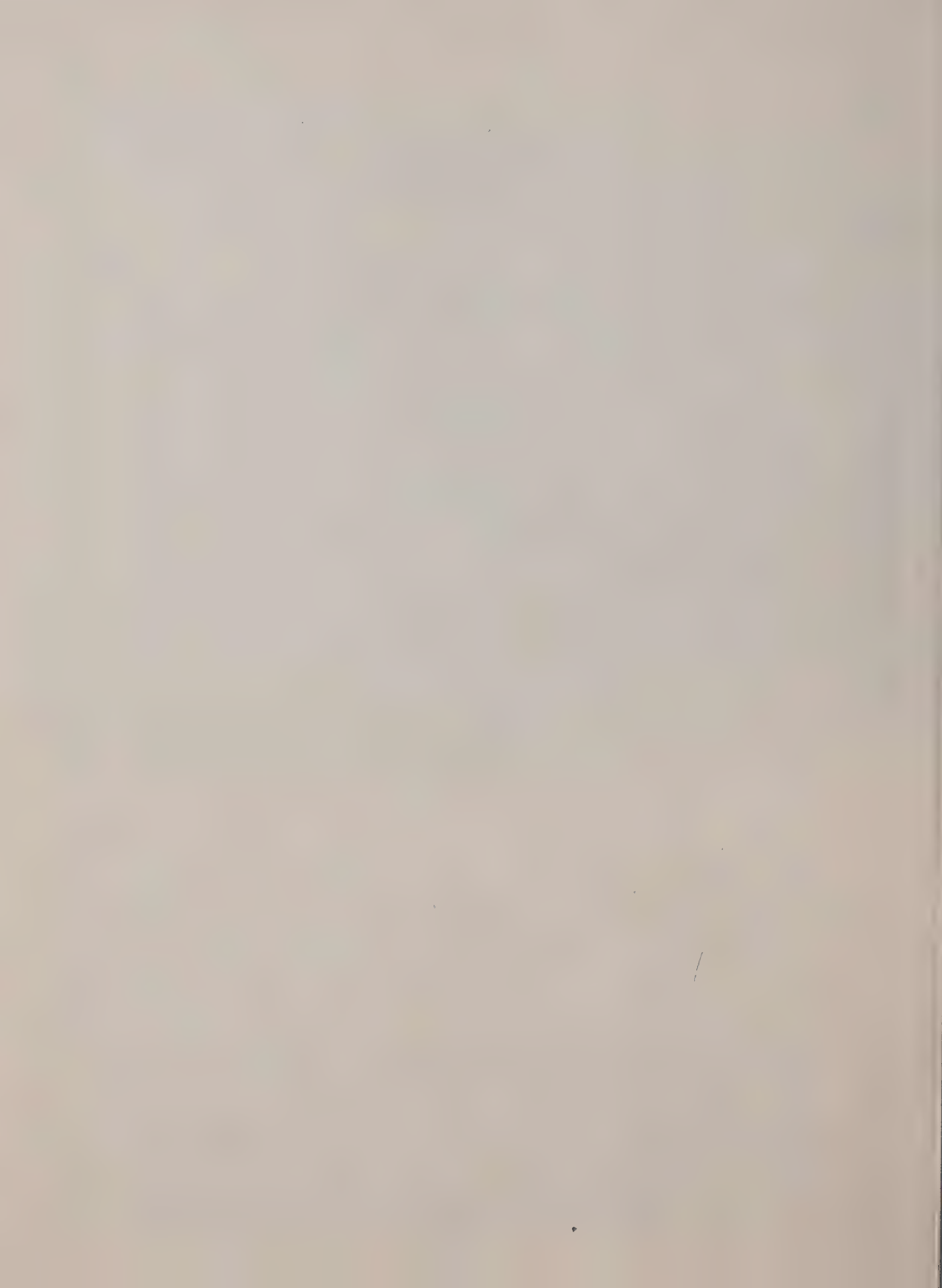
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INTRODUCTION

The format of this year's annual *Economic Survey of Asia and the Far East* has been altered to emphasize regional appraisal rather than review of development in individual member countries in accordance with the twenty-seventh session Commission resolution No. 118 (XXVII). The secretariat is aiming at a biennial regional appraisal cycle in the contents of the annual *Survey*, so that it presents a full-scale background to global appraisal each second year, while, each other year, it limits the regional survey to a briefer description of regional developments, combined with a discussion of specific economic regional problems relevant to appraisal. Each year, the regional surveys will also include brief surveys of development in most of the region's individual countries.

The *Survey* for 1970 contained a full regional appraisal of economic and social developments during the First Development Decade. In the 1971 *Survey*, Part One considers a number of important and common regional economic problems, including the relation between economic growth and social justice, the continued persistence of widespread unemployment and underemployment and problems associated with income distribution. Part Two includes a brief review of regional economic developments in 1970 and 1971 and a discussion of the recent international monetary crisis and its implications for ECAFE developing countries, followed by a series of succinct notes on the economic performance of the individual countries of the region.

The Second Development Decade and the ECAFE region

In its Declaration proclaiming the Second Development Decade,¹ the United Nations General Assembly outlined a strategy for the decade that contained a programme of international development activities.

The Declaration stated that the average annual rate of growth of the gross product of developing countries as a whole should be at least 6 per cent, with the possibility of a higher rate in the second half of the decade. At an average annual population increase of 2.5 per cent in these countries, the average annual rate of growth of gross product per head should be about 3.5 per cent, with the possibility of an acceleration during the second half of the decade.

These targets were set forth only as broad indicators. It should be the responsibility of each developing country to set its own growth target in the light of its own circumstances. In countries with a low increase in gross product per head, efforts should be made to reach higher growth rates than those indicated above.

The over-all output growth rate of 6 per cent implies an average annual expansion of 4 per cent in agricultural and 8 per cent in manufacturing output. It would require an average annual expansion of 0.5 percentage points in the ratio of gross domestic saving to gross product for this ratio to rise to around 20 per cent by 1980, requiring a somewhat less than 7 per cent rate of increase in imports and a somewhat greater than 7 per cent rate of increase in exports.

In addition to these quantitative macro-economic targets, the strategy called for a more equitable distribution of income and wealth in order to promote both social justice and efficiency of production, a substantial rise in the level of employment, the achievement of a greater degree of income security, the expansion and improvement of facilities for education, health, nutrition, housing and social welfare, and the safeguarding of the environment. Existing disparities, regional, sectoral and social, should be substantially reduced. A number of these qualitative targets were specified in some detail.

The urgency with which these objectives should be pursued varies between regions and countries. An important task of the regional commissions is to identify especially urgent problems in each of the regions. It would seem that, in some of the developing countries of the ECAFE region, eradication of mass poverty is the overriding problem in improving social justice and efficiency in production and, hence, of equity in the distribution of income. With unemployment and underemployment in the developing countries of the region continuing at intolerably high levels, an increase in the volume of remunerative employment stands out as an important means of reducing mass poverty and improving income distribution.

Whereas the strategy of the Second Development Decade generally recommends that developing countries formulate their national employment objectives to absorb an increasing proportion of their working populations in modern-type activities, the experience of the developing countries of the ECAFE region during the 1960s demonstrated that only a modest

¹ A/RES/2626 (XXV), 11 November 1970.

part of the increase in the labour force is being absorbed by manufacturing industry. Absorption of the total labour force increase into this industry, not to speak of the existing unemployed and underemployed labour force, would require an expansion of manufacturing output and investment far beyond what can realistically be expected in most of these countries. A substantial increase in employment in agriculture therefore seems imperative, and, for the region as a whole, the success of the Second Development Decade will hinge largely on whether the countries in question are successful in this respect.

Considering the inadequacy of development-oriented economic institutions in some of the countries of the region where mass poverty and unemployment and underemployment are serious problems, and considering more generally the above-mentioned modest strategy objective, modernization of the institutional infrastructure and improvement of existing economic and social policy instruments seem to be a necessary general precondition for the success of the Second Development Decade.

The strategy for the Second Development Decade called for appraisals of achievements at the national, regional and global levels. For regional appraisals, the regional economic commissions, in co-operation with regional development banks and subregional groupings, and with the assistance of other organizations in the United Nations system, will assume the main responsibility. 1971 is the first year of the Second Development Decade. Data on developments during 1971 are too limited, as yet, for a full regional appraisal of the achievements in 1971. As an overture to the forthcoming biennial regional appraisals to be made in 1972, this *Survey* has devoted the three chapters in Part One to problems of special importance to the ECAFE region.

Chapter I (Part One), on "Economic growth and social justice", takes up for discussion the problem of possible conflicts between growth and social justice targets. While it is widely contended that there is a necessary trade-off between growth and social justice, it is here maintained that there may be complementarities between these targets so that measures to promote social justice may serve as a vehicle for growth. Even where such complementarities are not present, however, trade-offs can often be avoided or at least mitigated by the application of appropriate policy instruments. The improvement of policy instruments, and the need for innovations in the field of both institutions and instruments, is therefore emphasized.

Chapter II (Part One) deals with "Economic growth and employment". A characteristic feature of

the 1960s in the developing ECAFE countries was the very strong decrease in employment per unit of output in manufacturing industry, partly due to an emphasis on capital-intensive techniques. Despite a rapid increase in output in manufacturing industry, industrial employment has increased at a much more modest rate. Investment incentive policies have often tended to promote capital-intensive rather than labour-intensive techniques. Methods are discussed in this chapter for rectifying such anomalies in development policies. Manufacturing industry can at best be expected to absorb a fraction of the increase in manpower during the Second Development Decade. Economic policy has to search for other employment outlets, and agriculture seems at present the most promising field. In some countries, redistribution of land accompanied by institutional reforms may help to create both employment and an increase in output; and the adoption of more labour-intensive crops and methods of cultivation may work in the same direction.

It is uncertain, however, how much manpower can be absorbed by agriculture under favourable circumstances, and it is not known whether the labour-absorptive capacity of agriculture will suffice as a means of solving the employment problem. The First Development Decade started in the hope that manufacturing industry would largely solve the employment problem. The development trends of the 1960s proved such hopes to be unfounded. It would be unfortunate if Governments at the beginning of the Second Development Decade contented themselves with the hope that agriculture under the impact of the "green revolution" can solve the employment problem—only to be disproved by developments during the 1970s. It is of utmost importance, therefore, that the employment possibilities of agriculture be studied in the developing countries of the region. In any case, the whole employment problem needs urgent rethinking, a task on which this chapter makes a start.

Chapter III (Part One), on "Growth and income distribution" presents some empirical material on income distribution and its changes in some of the developing countries of the region. It is widely believed that income distribution, in the absence of special measures, may tend to become more unequal during the first phases of industrialization. The available evidence from developing countries in the ECAFE region gives some support for this view. While distribution in rural areas seems generally to have changed little during the last decade, distribution in urban areas seem to have deteriorated in most countries. Since, moreover, income distribution is generally more unequal in urban than in rural areas, and urbanization everywhere has progressed,

the result is that the over-all income distribution within the ECAFE region has tended to deteriorate. The need for better data and further research in the field are emphasized in this chapter.

Current economic developments

(a) *The international situation, 1970/71*

Because of their greater economic weight, the policies and performances of the main industrial countries significantly influence the tempo of economic growth in other countries. The most notable developments in the world economy were a slowing down in the growth of world output at continuing high levels of unemployment, a continued inflation in industrial and non-industrial countries, the spillover of domestic price increases into international trade, and a generally adverse shift in the terms of trade of the developing countries *vis à vis* the richer industrial nations.

Total world output grew at only 3 per cent in real terms in 1970, which was considerably below the 5 per cent per annum growth rate recorded in the 1960s. Inflation in nearly all major industrial nations remained strong despite the anti-inflationary policies adopted in 1970. As measured by the GNP deflator, inflation in industrial countries proceeded at nearly 6 per cent in 1970, which was in excess of the rate of inflation in the past decade. In the developing economies, increases in consumer price indices averaged around 9 per cent, which was considerably higher than in 1969.

The likely trends in output and prices in 1972 have been made more difficult to predict as a result of the recent exchange rate alterations. Following the check to the rate of increases in output in 1970, most Governments in industrial countries turned to expansionary policies. Prospects for mid-1972 are for fairly rapid expansion of output in North America, for somewhat below-average growth in other major industrial countries (especially Japan), and for rather slow expansion in smaller industrial countries. Only moderate success can be expected to result from efforts to reduce inflation.

The international development of inflationary forces is evident in the statistics on world trade. Contrary to the previous marked stability of the prices of internationally traded goods, there was an increase in such prices in 1969 and an even sharper increase in 1970. Of the 15 per cent expansion in the value of world trade in 1970, some 6 per cent was due to rising prices. However, while in volume terms the expansion of world trade was less in 1970 than in the two preceding years, it was still above the average

of the First United Nations Development Decade. Current indications suggest that this decrease in the rate of growth in the value and volume of world trade has continued in 1971.

The rise in prices of internationally traded goods has occurred mainly in manufactures, and, as a result, the terms of trade of the developing economies have shifted in an adverse direction. This has reduced the purchasing power of their quite substantial increase in export earnings and exacerbated problems of import requirements and debt servicing commitments and development generally. In real terms, the value of export earnings of the developing countries increased by 5 per cent in 1970, which was well below the exceptional increases of 10 per cent in 1968 and 1969.

(b) *ECAFE developing countries*

While there were exceptions, the developing countries of the region, when considered as a whole, recorded impressive increases in the level of real gross national product in 1970. From preliminary evidence available, it is obvious that these increases continued in 1971.

Of the 23 developing countries in the region considered in the *Survey*, ten recorded increases in real gross national product in excess of 6 per cent, five recorded increases of between 4 and 6 per cent and eight increases of 4 per cent or less (in one or two cases a decrease). Of particular note was the continued success of the more export-oriented economies in maintaining high rates of economic development, and the solid performances of Indonesia and India. The unsatisfactory performance of the eight countries in the lower group (with the exception of Pakistan and the Republic of Viet-Nam these are among the smallest countries in the region) was a result either of disturbed political conditions, of adverse climatic factors or for the land-locked nature of the economy concerned.

In agriculture, the performance was a mixed one, with the showing of individual countries being affected by the spread of the "green revolution" and by climatic factors. In approximately 50 per cent of the countries, the growth rate in agricultural output was greater than in the 1960s.

Because nearly 50 per cent of the work force in the region is employed in agriculture, the successful extension of the "green revolution" is extremely important in the ECAFE region. If it is to become a continuing dynamic force in the region, a number of urgent problems must be resolved. In particular, attention needs be paid to extending the technical

benefits of the "green revolution", to maintaining an efficient allocation of resources in agriculture, and to mitigating some of the income distribution effects which are emerging.

Although estimates of industrial output for ECAFE developing countries in 1970 and 1971 are not yet to hand, enough information is available to reach some tentative conclusions about activity in this sector in the last two years. Some 80 per cent of the countries examined attained or nearly attained the average rate of increase in manufacturing output achieved in the 1960s. The performance was particularly impressive in Indonesia, the Republic of Korea and Malaysia. Individual achievements were strongly influenced by world trade developments where the manufacturing sectors were export-oriented and by balance of payments considerations where industrial output was closely linked to the availability of imported raw materials, semi-processed products and capital equipment. In other instances, it was the low level of investment activity which was the cause of an unsatisfactory level of output.

The recent international trade performance of selected ECAFE countries is satisfactory. However, while the average rate of export expansion in 1970 was almost twice the average rate experienced in the period 1960-1970, the average performance in 1970 was less impressive than the record performance of 1969. Nevertheless, the majority of the developing countries examined improved in absolute terms upon their export growth performance of the previous year. While no quantitative measure is available, the expansion of exports in real terms would not have been significantly less because there was a tendency for the prices of the exports of developing countries in the region to lag behind general worldwide rates of inflation.

In 1970, for ECAFE developing countries considered as a whole, import demand grew at roughly the same rate as in 1969. Generally, the import demand of individual countries was affected by the rate of expansion in their gross national product and by the ability of the country concerned to acquire foreign exchange by drawing upon its international reserves, by the receipt of concessionary and non-concessionary capital flows, and by its export performance.

The evidence so far to hand does not indicate any necessary slowing down in the rate of increase in the value of trade in the region in 1971 as compared with 1970. However, the evidence is fragmentary and most of it relates only to trade in the first two quarters of 1971.

Data available for 1970 confirm certain trends taking place in the composition and magnitude of the flows of foreign capital to developing countries. Total net capital flows to developing countries as a whole in 1970 approximated US\$15 billion, an increase of nearly US\$1 billion over 1969 in current prices, but, in real terms, there may have been a fall.

Within the ECAFE region as a whole, although there are some pronounced subregional differences, the net transfer of resources has been declining in real and nominal terms. In east Asia, total disbursements of contracted loans, grants, etc., increased steadily from 1965 until 1969, but the absolute amount of grants reached a peak in 1968 and dropped abruptly in 1969 to approximately the same level as in 1965. If allowance is made for amortization and interest payments, the net transfer of resources to east Asia nearly doubled in terms of current prices between 1965 and 1969.

The experience of south Asia has not been so fortunate. Total disbursements measured in current prices had fallen by nearly 20 per cent between 1965 and 1969, and, in terms of the net transfer of resources, the 1969 level was nearly 40 per cent less than that of 1965. In real terms, the difference would be even greater.

The composition of foreign capital inflows to ECAFE developing countries has also altered, emphasizing the increasing importance of suppliers' credits and official bilateral loans and credits, and the dwindling role of official grants.

The international monetary situation

There is widespread recognition that the malfunctioning of the international monetary system is not the fault of the developing countries, yet they suffer most from it as a result of effects on their trade and foreign assistance flows. It is essential to them that a comprehensive and useful reform of the system emerge from the recent crisis.

In Part Two, Chapter III, a general discussion of this issue is presented. The historical background to the crisis is discussed; developments to date, especially exchange rate realignments are described; a number of as yet unresolved issues are examined; and, finally, a brief and general discussion of the likely impact of these developments on ECAFE developing countries is given.

The disequilibrium in the international monetary system had been building up over several years, with the continuing weakness in the United States balance

of payments and the surpluses of some other countries, particularly the Federal Republic of Germany and France, and, more recently, Japan. The crisis came to a head during 1971 with a further rapid deterioration in the United States balance of payments and recognition that the revaluation of several major currencies relative to the dollar was inevitable. The crisis was precipitated by measures introduced in August 1971 by the United States to improve that country's balance of payments and to counter the dual problem of inflation and unemployment. These measures, which included the ending of the commitment to sell gold, the introduction of a 10 per cent tariff surcharge on non-quota imports, tax reliefs that discriminate against imported equipment, and cuts in foreign aid, were clearly intended to force the United States' trading partners to take measures to reduce their balance of payments surpluses, and, in particular, to appreciate their exchange rates relative to the dollar.

By the end of 1971 some progress had been made towards the resolution of the crisis. New parity exchange rates of the major industrial countries were fixed at the December meeting of Finance Ministers of the Group of Ten industrial countries. It was agreed that the margins around parity should be temporarily widened from 1 per cent to 2.25 per cent. The United States has removed the 10 per cent tariff surcharge and the discriminatory tax reliefs—the two measures that most militated against trade. Prior to the December agreement, exchange rates were drifting in the direction of the new parity values, but there had been disagreement about the extent of realignment required and about the price of gold. The settlement of the Group of Ten exchange rates was rapidly followed by a fixing of the exchange rates of most other countries, including the countries of the ECAFE region.

It is probable that ECAFE developing countries will benefit from the international monetary reform accomplished so far. The adoption of more flexible exchange rates and the realignment of currency values are likely to be beneficial to developing countries, provided that these changes occur in a way that encourages an expansion of world economic activity and trade.

More frequent changes in the exchange rates of the industrial countries should create no serious problems for developing countries, although these countries would themselves be well advised to adopt more positive exchange rate policies so as to facilitate adjustment to such changes.

The specific realignment of currency values might cause some problems to particular countries in the short run. These are unlikely to be severe once there has been time for adjustments to the relative price changes to occur, and they should be negligible compared with the beneficial effects of an expanding world economy.

Because of the importance of the international monetary system in providing a setting in which the world economy can expand, the authorities of the developing countries should do their best to ensure that the realignment of exchange rates is accompanied by measures for the expansion of international liquidity, including aid. In particular, the interest of the developing countries in the operation of the international monetary system should be fully recognized in the institutional reforms that emerge.

As far as ECAFE developing countries are concerned, the increased willingness of countries to cooperate among themselves in seeking satisfactory international financial arrangements augurs well for the development of such regional projects as the Asian Clearing Union and an Asian Reserve Bank.

ECONOMIC SURVEY OF ASIA AND THE FAR EAST, 1971

PART ONE

**SOCIAL JUSTICE, EMPLOYMENT, AND INCOME DISTRIBUTION
IN THE ECAFE REGION**

SOCIAL JUSTICE, EMPLOYMENT, AND INCOME DISTRIBUTION IN THE ECAFE REGION

Chapter I

ECONOMIC GROWTH AND SOCIAL JUSTICE¹

The realization of the broad spectrum of objectives set out in the United Nations Second Development Decade strategy will give rise to many intricate problems. Apart from a series of recommendations related to international trade and aid, the United Nations proclamation does not offer much advice on how to realize all the development and social justice goals, but seems to assume that these goals are to some extent complementary. Since the professional literature on the subject, by and large, tends to take the opposite view, this chapter will concentrate on the possible conflict between development and social justice goals, and its resolution. The discussion is at a relatively abstract level although illustrated by concrete examples. Nevertheless, the chapter concludes with some concrete suggestions on possible strategies to be adopted for the realization of development and social justice in this region.

A. The conflict between development and social justice

In the development literature it is almost taken as an axiom that development and social justice are conflicting goals, between which a trade-off is inevitable and that the best we can hope for is a trade-off that is optimal in some sense. Conflict arises because development is identified with production, or income *per capita* and its rate of change, and because it is believed that measures to improve social justice or economic quality will inevitably lead to a decline in income and its rate of growth.

Genuine conflicts of goals can only be resolved through the political process. However, political struggles over social justice issues may be extremely bitter. It is important, therefore, that the nature of such conflict be investigated carefully. Conflicts may be only apparent, or they may be tackled by a variety of methods, some of which may be less painful than others. Economic policy is an art whose main problem often is to invent new methods of intervention rather than to select between old and well known methods; and it may happen that too little time and

energy have been invested in innovating new approaches in this field. On closer consideration, the conflict between development and social justice may therefore turn out to be less absolute and more amenable to solution than traditionally has been held; with adequate policy measures the optimistic attitude of the United Nations may after all prove to be justified.

As an introductory statement, it may be useful to make a few remarks about *per capita* income and its growth rate and social justice as targets in economic policy.

Development and income per capita

The basic motivation for identifying development with production and income *per capita* is, loosely speaking, that the more we produce, the better we are off and the more do we have at our disposal for investment and consumption. Regardless of whether we want to emphasize present or future consumption, we should make sure that present production and income are at a maximum. For any given level of present consumption we then ensure a maximum of growth in future consumption; for any given growth target, we ensure a maximum of present consumption. This concept of development, however, is not without its problems.

To justify the use of national income *per capita* and its rate of growth as measures of development, the economic theory of welfare postulates a society in which there are no problems of distribution: a society whose members are all identical in regard to inherited wealth, opportunities, natural abilities and preferences. The only dimension, if any, of social justice left to be solved or improved upon would then be the level of production and welfare. It is generally recognized today, however, that not even in this imaginary society does real national income *per capita* on standard definitions (e.g. United Nations definitions) measure welfare levels adequately. On standard definitions, the concept of national income has a number of serious shortcomings. Thus, activities that inflict direct suffering upon a population (armies persecuting minorities or repressing opposition, or waging wars against neighbours; secret police,

¹ The contents of this chapter are based on an article with the same title prepared for ECAFE by Professor Bent Hansen, University of California at Berkeley.

etc.) have no value whatever to add to measured national income. Important externalities, positive or negative, do not directly affect measured national income, whereas costs incurred to counter negative externalities inflate measured national income. Household activities (domestic crafts), rapidly disappearing in developing, low-income countries, and later reappearing (albeit in other forms) in affluent countries, as well as changes in leisure, are not accounted for. A number of other shortcomings related to the process of growth in the production of commodities and services could be listed. Thus, even in the simplest and most favourable of cases, a perfectly egalitarian society, the national income is a biased, perhaps even a seriously distorted indicator of welfare.

Moreover, if the distribution of wealth and income and opportunities is not ideal it cannot simply be argued that the more we produce, the more we have for distribution. For the prices used in the estimates of national production, income or expenditure may not adequately express the social importance of individual commodities or services. Both levels and rates of change of national income may for this reason be further distorted. It is debatable as to which prices should be used in measuring national income and its rate of change. It has recently been argued that the correct procedure in any case—that is, independent of domestic conditions—would be to use international prices in national income estimates. Compared with current methods, this might imply different levels and rates of growth of national income; but it would have the advantage of furnishing an objective yardstick independent of domestic preferences and distribution of income and wealth. Unfortunately, however, it is by no means obvious that this evaluation method is correct; it leads to great difficulties in practical estimations, and it does not really dispose of the problem of domestic distribution of income and wealth.

It may be argued that all these problems are statistical technicalities that could be resolved in such a way that we could come out with a reasonably meaningful and accurate indicator of "what is available" for investment and consumption, and for distribution among the individual members of society. The problems involved are much the same as those encountered in the construction of cost-of-living indexes where, in spite of all theoretical and practical problems, generally accepted indexes are in fact constructed in many countries. Work on indicators of this type is in fact in progress. In what follows it shall be assumed that a generally acceptable—albeit most probably not objective—and reasonably accurate measure of income *per capita* is available, so

that we can identify the problem of development and social justice with the problem of a trade-off between the level and rate of growth of national income *per capita* on the one hand, and social justice on the other hand.

What is social justice?

Improved social justice means a change in the direction of increased economic equality. It is invariably social justice in this sense that is supposed to conflict with development. Even so, social justice has many dimensions. They may be summarized under three headings: wealth, income and opportunity. The distribution of wealth, income and opportunity are, of course, highly interrelated, yet it is useful to keep them separate. They may, for instance, be goals in themselves. Moreover, wealth does not only bring income; it also brings power. Equal opportunity may be a question of the dignity of man as much as a question of money income. And even if income and its distribution should be the ultimate goal of social justice, the only practical way to equalize income distribution may be through improving the distribution of wealth and opportunity.

Wealth in undeveloped countries consists mainly of land (including water and other natural resources), livestock, buildings, stocks of commodities and some mobile property, and cash (including gold and silver). As development proceeds, productive capital in modern forms (machinery and equipment) gains importance, and, with the emergence of private corporate business and financial intermediaries, financial investment finally predominates in personal wealth. At the undeveloped end of the spectrum, feelings of social injustice may be particularly stirred up when large-scale landed property, based on inherited feudal rights and other forms of "primitive" accumulation with absentee landownership, coexists with massive small-scale tenancy or share cropping and a landless rural proletariat. Action for improved social justice may then take the form of land reform with land redistribution (with or without compensation to the old owners). In countries where development has proceeded further, feelings of social injustice may in addition be related to large-scale, privately-owned modern business, and to financial power centred in the banking system. Action may then take the form of government or workers' participation and control, or the outright nationalization of such enterprises. Estate and inheritance taxation are universally accepted instruments for influencing the distribution of wealth without interfering with private ownership as such, but to be effective they do require a relatively advanced tax administration.

Income distribution itself has several dimensions, of which the two "classical" ones are functional and personal income distribution. In the development processes, distribution by sectors is often important for understanding the aggregate developments of both functional and personal distributions of income.

Functionally, income is derived from the factors of production, labour, land and capital. From a functional point of view, income of labour and land predominates in undeveloped countries. During the process of development, the shares of both labour and capital tend to increase, and that of land to fall sharply. Relatively little is known about the changes in personal income distribution that take place during the process of development, and it is difficult to generalize on the basis of existing empirical information. While highly developed countries generally seem to have more equal personal income distributions than less developed countries, it has been hypothesized that, during the first stages of industrialization, income distribution should nevertheless tend to become more unequal. But even here the evidence is not clear. In any case, personal income distribution will tend to be related to the distribution of wealth; thus, in an undeveloped country, land reform will most probably help to cut away the upper tail of the personal income distribution and thus help to improve income distribution.

Philosophies of social justice have always been much concerned with functional income distribution and often single out income of land and capital as "unearned" and, hence, unjust; but size distribution plays an important role, too, and this leads to difficulties in appraising personal income distribution. Both the income of land and capital may accrue to families in the lower income brackets. This will tend to be the case when agriculture is dominated by small owner-cultivators and trade and production are in the hands of small-scale retail trades and handicrafts. Higher income brackets (albeit not the highest ones) may, on the other hand, comprise a lot of labour income—incomes of managers, professionals, and civil servants. And compared with landless labourers and urban paupers, workers in the modern industry sector and civil servants may be privileged and pampered groups at a relatively high income level. With "material incentives" that allow labour to be paid according to its contribution to production, substantial inequalities of personal income distribution may prevail, even though private income of land and capital has been completely abolished; recent divergencies in the communist camp and the cultural revolution in the People's Republic of China arose partly over this issue. As long as feelings of social injustice are mainly provoked by the existence of personal incomes that are both large and "unearned", the

problem is really one of the distribution of wealth and could in undeveloped countries largely be dealt with through land reform. At higher levels of development, redistribution of wealth is a much more complicated matter. Even in a situation where the possibility of a more equal wealth distribution has been exhausted, income differentials may prevail that are intolerable from a social justice point of view. The highly developed countries have invented and instituted a number of devices for transferring and redistributing income. How effective they are is disputed and depends largely upon the shifting and incidence of taxation and subsidies, about which relatively little is known (as an example, take the discussion of the shifting on to prices or backwards to labour, of corporate income taxes). An important problem here is to what extent such devices, if at all applicable in developing countries, will hamper development efforts.

Opportunity is a wide and vague heading under which all inequalities among social, occupational, geographical, regional, tribal, cultural, racial, linguistic, religious, age, sex, and other groups of population may be discussed in regard to rights and duties, and access to benefits from public services and development efforts. In some countries, outright discrimination against, and even persecution of particular groups take place; nepotism that favours those close to the ruling clique is all too frequent. Even disregarding such glaring inequalities in opportunity, the distribution of educational and health facilities between urban and rural areas is in most countries a case in point. Investment patterns and the creation of employment and production possibilities as laid down in the government's long-term investment plans, and their execution as determined by annual budgeting or financial availability, also more often than not affect the population very unevenly. Social security programmes usually apply to the "organized" sectors (government and big enterprises) only, to mention some examples. To some extent, inequality in opportunities will be reflected in current income levels and their rates of change, but money income may often only be affected after generations (in the case of education), and the distribution of benefits from a number of current government services (justice, security, etc.) may not reflect itself at all in money income.

Problems related to opportunity tend to be particularly acute in heterogeneous societies. It is well known that not even the richest country in the world has been very successful in solving this kind of problem, and those rich countries that appear successful in this regard are precisely those small, homogeneous countries that have never had any serious problems of this type to solve. Most of the new

independent nations are faced with these problems — some of them overwhelmingly — with which they were born. It is impossible to devise general methods for removing such inequalities; in many cases they do, perhaps, depend on the degree of centralization of government decisions and administration, which in turn may be of much consequence for the planning and implementation of economic policy. Decentralization may be necessary to overcome such problems.

These brief considerations, subsumed under wealth, income, and opportunity, do not pretend to be anything like a complete list of issues of social justice. The issues vary from country to country, and what is a major problem in one social context may be a minor nuisance in another one. There are problems that do not lend themselves easily to be discussed under these three headings, but, for the present discussion, this brief summary may perhaps suffice.

Since the problem of social justice in most cases is a problem of the distribution of this or that, the statistical measurement of the inequality of distributions is important. It is well known that as soon as more than two groups are involved — and that will often be the case — there does not exist any natural or objective measure of inequality. The traditionally used measures may give different answers in a concrete situation. When that is the case — and it often is — we cannot really say whether equality has increased or not, unless we choose to identify equality with one particular statistical measure. Fortunately, from a statistical point of view, some of the inequalities actually existing in less developed countries are so glaring, or are a problem of distribution between so few groups, that these measurement problems are a minor consideration. In what follows, it shall be assumed that equality is a well-defined and measurable concept.

Conflicts of goals and trade-off of goals

That there is conflict between goals does not necessarily mean that we are confronted with a situation that can be resolved by a trade-off. If goals are absolute and non-negotiable, trade-offs have been excluded *a priori*. There is nothing particularly irrational or doctrinal about setting up absolute targets. They only imply that we have to search for a set of policy instruments that is capable of fulfilling the targets exactly. From the theory of economic policy, as originally developed by Tinbergen, we know that we generally need the same number of instruments as we have absolute targets. Whether a concrete policy problem with absolute targets has a solution has, therefore, to be studied case by case, and the

existence of a solution will depend upon the nature of the targets, the economy (the model), and the policy instruments available; and, of course, in a concrete situation, there may not exist a sufficient number of available instruments that are capable of solving the problem. That an instrument is "available" here means not only that the instrument and its effect are known, but also that it is "permitted", in the sense that politicians are willing to use it. Land reform is known as an effective instrument for equalizing distribution of both income and wealth, but it may not be permitted by politicians to whom private property rights are sacrosanct. Liberal ideology may not permit physical controls. Socialists may solve problems that have no solution within the frame of a liberal ideology, and so forth. If there is conflict between goals in this sense, either politicians will have to revise their goals, or new instruments will have to be invented, or the problem will be left unsolved. In fact, innovations in the "technology" of policy-making have often been induced by the emergence of such conflicts, where the only way of solving the conflict has been to devise entirely new policy instruments.

When targets are absolute, it follows that, if social justice targets are added to existing growth targets, the fulfilment of the set of targets thus extended requires an increase in the number of instruments applied. Whether a set of instruments is available that can solve the extended problem cannot be said *a priori*, but it deserves emphasis that if politicians are prepared to use more instruments, there is no *a priori* reason why growth targets should have to be sacrificed for the sake of social justice, and *vice versa*. In this sense, traditional views on the possible conflict between growth and social justice seems to be unnecessarily pessimistic. It has, of course, to be admitted that a sufficient number of permitted instruments that can handle both kinds of targets simultaneously may not exist in a developing country, but that is something that only careful investigation can reveal.

More commonly, however, targets are relative and negotiable, so that a trade-off is envisaged where achievements in different directions are traded against each other; the problem then is to find an optimal solution. Optimization can in principle be carried out at any given set of instruments, and the trade-off problem is never fully defined without a complete specification of the available policy instruments. Although we may optimize at any given set of instruments, it does not follow that the number of instruments is of no consequence in trade-off problems. The more instruments that are applied in a given trade-off problem, the more use will be made of each single instrument, and the better may be the results

obtained. Under special circumstances, an absolute optimum may be reached when the number of instruments equals the number of target variables between which trade-off takes place, but, until such an absolute optimum has been reached, it remains true that an increase in the number of instruments tends to improve performance.

An example may clarify this important relationship. The so-called Phillips curve expresses an allegedly necessary trade-off between unemployment and inflation, granted that only general demand management instruments are used. If, however, a new instrument can be added that is capable of shifting the Phillips curve downwards to the left, it will be possible to diminish unemployment and inflation simultaneously. Various instruments have been suggested for this purpose, income policy and labour market policy being the best known. The example illustrates that a trade-off situation is not fully defined until all instruments have been specified, that increasing the number of instruments tends to give better results; and that innovation may improve the technology of economic policy-making.

But a *caveat* is required: it does not follow that the more intervention the better, or that, because socialists tend to permit more instruments to be used than, say, liberal politicians, socialist policies should always tend to perform better than liberal policies. Quite apart from the fact that socialists usually have other preferences than liberals, which may make comparisons of performances of socialist and liberal policies impossible, or at least highly arbitrary, the statement "the more instruments the better" does not mean that any $n + 1$ instruments are better than any other n instruments. There are good and bad instruments (even at a given social utility function), in terms of the utility increment that an instrument can create. A socialist might perhaps choose a large number of bad instruments, while a liberal might choose a small number of good instruments and thus come out with the better result. Indeed, disagreement between socialists and liberals is more often related to the nature than to the number of instruments applied. That policy performances tend to improve when more instruments are applied means only that, if a new instrument is added to an already existing set of instruments, performances will tend to improve. Only in this sense is it true that less trade-off is required the more instruments we apply.

On the other hand, it does follow, of course, that less developed countries always tend to show relatively poor policy performances because, as an aspect of underdevelopedness itself, they master relatively few policy instruments, and do not master them very well.

This obvious circumstance should not by itself discourage less developed countries from including social justice among their policy targets. Imperfect policies are better than no policies at all, unless we insist that policy-making in less developed countries is so bad that it does more harm than good. Instances of bad and even catastrophic policies can easily be mentioned, but they do not really render support for non-interventionist philosophies of this sort. More often than not, the responsibility for bad policy can be traced back to political constraints rather than bad advisers; that policy advice may also have been bad in many instances does not preclude that better advice could have been given. Assuming that serious policy-makers assisted by serious policy-advisers make the best of the circumstances, we have every reason for believing that imperfect policies are better than no policies.

A more important argument against adopting social justice targets is that, if the situation is already one of trade-off, additional target variables would imply additional trade-off, and would thus inevitably lead to less favourable growth performances. This is presumably what many development economists have in mind when they warn against policies that concentrate on social justice. Once more, however, we have to consider which new policy instruments can be brought to bear upon the problem. If additional good policy instruments can be introduced, it is not obvious whether and in what sense policy performances should necessarily deteriorate as a consequence of improved social justice. The problem is complicated, however, by the fact that we are considering a shift from one set of social values to another.

It is clear, however, that, even if previous growth policies have been well-designed, growth performances need not necessarily deteriorate because social justice targets are added to the picture. And, if the previous growth policies were inoptimal, there may even be a possibility of improving growth performances at the same time as social justice is improved.

The *first* possibility arises only when there are instruments that can improve social injustice without affecting the growth variables; a policy that is totally indifferent to social justice would have no reason for using such instruments, and a policy that is also concerned with social justice would certainly pick up such instruments. A number of social security arrangements could be mentioned here. If based on pay-roll taxes, they may only imply redistribution between employed and unemployed, between healthy and sick, and between young and old, but, nevertheless, be important from a social justice point of view because they remove insecurity for the lower income brackets.

The *second* possibility arises when there are instruments that could improve growth and at the same time would improve social justice, but for some reason were overlooked by the policy-maker. In the fields of agriculture and employment, in particular, there seem to be more such instruments than have been recognized in the past.

A *third* possibility is innovation with regard to policy instruments. Such innovation may either take the form of entirely new institutions and policy instruments, or improved knowledge about the effects of already existing policy instruments.

Finally, a *fourth* possibility for improving performance generally and according to all views on the importance of various targets is that those who advocate growth *cum* social justice are also willing to permit instruments that are not permissible to those who think that policy should concentrate on growth. But, in this case, it could be argued that there is, indeed, a trade-off between instruments and targets.

In other cases, there would be trade-off in the sense that growth performance considered in isolation would deteriorate, while growth *cum* social justice performance improves. It goes without saying that, if we had compared two social views, one advocating growth *cum* social justice and one growth *cum* social injustice,² the possibility of "making everybody happy" diminishes; but even here the possibility cannot be ruled out of finding instruments that would improve the growth variables so much that, despite the simultaneous move towards greater social justice, even those who advocated social injustice would find that over-all policy performance had improved.

Summarizing, we can thus say that it is not generally true that a trade-off between growth and social justice is inevitable. If targets are *absolute*, there is by definition no trade-off, and additional instruments may exist, or can be found, so that a larger number of targets can be fulfilled. If targets are *relative*, so that we are confronted with optimization through trade-off, a deterioration of the growth variables may still be unnecessary if better instruments than those hitherto applied can be devised. The latter statement should not be read as a platitude saying the obvious thing that if policies were better, then everything could be better, regardless of whether we want social justice or not. It says much more than that. Permissible instruments may exist that together with or in lieu of already applied instruments can improve social justice without deteriorating growth, and have not been used so far simply because

there has not been sufficient interest in social justice. And the demand for innovation in the technology of economic policy is more than just wishful thinking, because we know that, practically speaking, all known policy instruments have been invented in response to a need.

B. Growth constraints and social justice

Having thus concluded that development *cum* social justice is essentially an instrument problem, the next logical step would be to study, in the context of a complete model for a particular country, to what extent the existing instruments do or do not suffice for solving problems of social justice with little or no trade-off in terms of development; one could alternatively work with absolute targets and postulated social utility functions. This road is not open, however, and probably never will be. Standard macro-models designed for development planning are usually not well specified for this purpose. Rarely, if ever, are they sufficiently detailed for pinpointing important social policy issues, and, in terms of policy instruments (be it in relation to development or social justice) they can only be characterized as poorly specified. This is true even for the most ambitious models that have been set up for developing countries. The extent of the success of the future research with macro-models that incorporate major social justice components in terms of distribution of wealth, income, and opportunities and yet are sufficiently specified in regard to development, is subject to conjecture. The large number of sectors and commodities to be dealt with tends by itself to make models very large; if, in addition, detailed specifications in regard to manpower, education, ownership and personal income distribution are to be incorporated, they will surely grow beyond manageable limits. The fact that even the largest econometric models for the United States economy throw almost no light on the major social problems of that country is not encouraging.

The need for adequate macro-models is necessitated by the fact that it is a problem of social justice for large population groups, and, in most instances, intervention for the sake of social justice will be important enough to warrant repercussions that may predominate over more direct, and more easily ascertained, partial effects. Fortunately, such repercussions can to some extent be studied with the help of existing macro-models; input-output models may thus be used to trace repercussions of changes in the composition of demand related to given shifts in income distribution. Generally, we will have to be content with a more simple partial analysis, and the most rewarding approach may be to concentrate the investigation upon what is believed to be the major

² Nobody favours injustice, of course, but one man's justice may be another man's injustice.

constraints upon development, to study the direct impact on them of improved social justice and to examine positive or negative effects of the policy instruments used for improving social justice. Such investigation should also include a reconsideration of all special instruments currently recommended and used for promoting development. Some of these instruments may have only marginal effects upon development but have obvious adverse effects upon income distribution. Some of the devices used for inducing private investment by extending various kinds of favours to private business may be of this kind.

The discussion will therefore concentrate on the following constraints which appear to be most important:

1. domestic saving;
2. physical investment capacity;
3. foreign exchange; and
4. skills and abilities of labour and management.

Some of these may be potential constraints only. Even if it could be shown that improved social justice tightens a particular constraint, it does not therefore follow that development will in fact be adversely affected. This will only happen if the constraint actually is or becomes binding; it was, *inter alia*, for ascertaining which constraints actually are binding that we would need a complete model.

Saving and social justice

This is the classical field of controversy between development and social justice policies. If the higher income brackets have higher marginal savings ratios than the lower income brackets, and social justice implies equalization of income distribution, the conclusion can only be that social justice implies a fall in both average and marginal savings ratios. The same argument applies to redistribution between income of capital and labour, if recipients of capital income have the higher marginal savings ratio, and to redistribution between the corporate business and non-corporate sector. With the Harrod-Domar and Kaldor models, or the Solow model as a starting point, most growth theories imply a positive correlation between savings ratio and growth rate and/or between savings ratio and capital intensity and, hence, *per capita* income. It follows then immediately that social justice leads to a lower growth rate and/or *per capita* income.

There are a number of flaws in this line of reasoning. Redistribution may transfer income from low saving groups in the higher income brackets (prodigal absentee landowners, say) to high-saving groups in the lower income brackets (parsimonious owner-cultivators) so that the effect on total private saving is uncertain. But the redistribution may as well work the other way: from high savers in high income brackets (corporate business) to low savers in low income brackets (workers), in which case the decline in total saving is accentuated. On balance, there is probably little doubt that redistribution of both wealth and income in favour of the lower wealth and income brackets tends to lower the over-all savings ratio.

There is, however, a possibility that the over-all capital-output ratio will also be affected by redistribution of income. If redistribution implies a lower capital-output ratio, the demand for saving needed to produce a given growth rate will correspondingly be lower and the effects of redistribution on the growth rate may cancel each other out. The idea behind this argument is that the composition of demand by commodities depends on income distribution because lower income groups' consumption is concentrated on simple, unsophisticated products from industries with a low capital-output ratio and a low capital-intensity. Whether this holds true is, of course, an empirical matter of income elasticities and capital-output ratios for individual sectors. Recent empirical work investigation tends, however, to indicate that the opposite is true. For Brazil, it has been found that redistribution in favour of the lower income brackets would in effect tend to lower employment mainly because durable consumer goods (automobiles, in particular) are produced there with relatively low capital-intensity whereas food is produced with relatively high capital-intensity. It would seem to follow that redistribution in favour of lower income brackets tend to increase capital requirements. These results are, clearly, highly dependent upon the special Brazilian setting and its particular structure of imports and industry. The modern Brazilian industry is to a large extent concentrated on durable consumer goods and other luxury goods. A different composition of domestic industry and imports might lead to the opposite result. These findings in a single case are clear warnings against simplistic theories in this field. If anything they indicate that the effects of redistribution via the composition of demand are small, and that countries interested in social justice should industrialize for supplying the needs of the lower income brackets rather than the middle and upper income groups. With an industrialization policy of this type, the effects of redistribution of income might be positive in regard to employment and imply lower capital requirements.

Leaving the question of the effect on the over-all capital-output ratio open, it should be emphasized that, even if redistribution with certainty would lead to a fall in private saving at given total income, an increase in public saving may compensate for the fall in private saving so that the over-all national savings ratio remains unchanged. And should the capital-output ratio increase, the increased need for savings could be met by a further increase in public savings. To increase public savings is, for all purposes and intents, a question of increasing taxation in some form. This, in turn, is partly a political, partly an administrative, problem.

In regard to the political problem, it might be argued that, if a policy of redistribution has been decided upon, there should be no such problem involved in the necessary increase in taxation. But that is not necessarily true. The decision to give to certain groups may not be accompanied by any decision to take from anybody. The realities of economic policy are like that. It is worth emphasizing, therefore, that precisely the process of giving may create political opportunities for levying taxes without resentment; but once such opportunities are foregone, they may be foregone forever. Land reform offers a good example of this political arithmetic. If it has been decided to redistribute land without compensation to the old owners, the problem is to levy a tax that will prevent total consumption from increasing (assuming the old owners to have a higher marginal propensity to save than the new ones). If a land tax is now levied on the new small owners to prevent their consumption from increasing more than the fall in the consumption of the old owners, the new owners will still be much better off than before land redistribution and may not feel the tax as any burden. Apart from the title deeds and the value ownership has in itself, the new owners will be able to experience an increase in income. There should be no administrative problems (deficiencies of land registration, cadastral surveys, etc.) involved in levying the land tax, because the land reform itself requires an identification of ownership. The land reforms of both Egypt and Iran are good examples of missed political opportunities for increasing or levying land taxes in a relatively painless way.

Similar opportunities for increasing taxes and public saving arise in connexion with social security arrangements that involve the imposition of social security contributions and accumulation of social security funds. Old age pensions to workers in modern industry offer a good example. If contributions are levied on employers, and pension rights are linked to the individual employee's time of member-

ship in the pension system, accumulation of funds will take place for a long time. The burden will rest on those who ultimately carry the incidence of the contributions. In the long run, at least, it seems likely that the contributions will be shifted backwards on to the wages and salaries of the insured employees; should backward shifting not take place, the contributions may be shifted on to prices, in which case the incidence is distributed somehow over the population as a whole (whether this is consistent with social justice is another matter) and problems of competitiveness and employment would arise. But backward shifting is the overwhelming probability. Social security schemes of this type do not redistribute income from capital to labour (as their advocates often seem to believe); nevertheless they do fulfil an important social justice function in redistributing income as between age groups (in the long run); and they are always highly appreciated because they give employees security. This is true even when part of the contributions are levied directly upon the employees. Some countries have been extremely successful in increasing public saving through social security programmes; the accumulation of funds and thus the increase of public savings may last for decades.

If, on the other hand, more traditional revenue sources have to be relied upon for increasing public saving in connexion with redistribution schemes which lower private saving, political resistance may be overwhelming; or the administration may only be capable of handling revenues that tend to reverse the initial redistribution of income or what other benefits have been given to special groups. In addition, some of the revenue sources that can be administered may have strong and unfortunate incentive and allocative effects. Export taxes on foreign trade is a case in point.

Finally, it should be emphasized from the point of view of social justice that public saving has the advantage that it will be accumulated in the public rather than in the private sector. From a social point of view, public saving may be considered superior to private saving; and particularly superior to savings out of profit. To replace private saving by public saving could be called "nationalization" of savings. With savings "nationalized", wealth will slowly be "nationalized" without the government ever depriving any citizen of his private property rights. Modern Western European socialism attaches much importance to this implication of public saving; it represents an alternative to the idea of gradual socialization through public investments because it does not imply government interference with production.

Physical investment capacity

Some observers believe that, in the early stages of development, the ability to erect investment structures and install and trim machinery and equipment sets an upper limit to the attainable growth rate. Generally we can speak about the propensity to invest in real capital as determined by abilities and cool profit considerations. Income redistribution may influence this constraint positively if redistribution shifts investment requirements in the direction of traditional investments, such as construction which can be mastered more readily by the available labour and management than investments in machinery and equipment. In addition to income elasticities and capital output ratios, "construction intensities" become decisive. Once more it is difficult to generalize without empirical studies of the type referred to in the last section. Special social programmes may involve large construction works, roads to villages, educational and health centres in rural areas, housing programmes and flood controls, and if planners are content with traditional types of structures there need be no special capacity limits for such investments. Reference could here be made to the massive flood control programmes in the People's Republic of China where extremely labour-intensive methods have been applied.

Extending the discussion at this point to the problem of inducing private investment we encounter the type of growth policy instruments that probably causes most grievance from a social justice point of view. On good theoretical grounds it is taken for granted that the higher net profits on investments are, the larger will private investments be. With this motivation, a number of profit increasing measures are used in most developing countries, such as tax credits or exemptions, accelerated depreciation and direct grants and subsidies. Little is known about their effects on private investment; that an instrument is efficient in highly developed countries does not guarantee that it works well in a less developed environment. If tax evasion is widespread, any measures that alleviate taxation will only legalize the existing practices and the effects on investments will be negligible. If, on the other hand, they actually do induce private investment, and the country does not want public investments, the need for such instruments may outweigh their negative impact on social justice; but the funds used for such subsidization of investments should then, as far as possible, be raised through taxes on the higher income brackets (e.g. taxes on luxury consumption); this problem will be further discussed in the chapter on employment. To the extent that the purpose is to reallocate investments from certain industries to other industries rather than to increase total private investment,

subsidies may be entirely unnecessary; what matters then is relative profits and they can be changed through taxing the low-priority industries instead of subsidizing the high-priority industries.

The foreign exchange constraint

Programming methods often identify foreign exchange as a binding constraint. In discussing the impact of social justice policies on this constraint we have to separate commodity trade and capital movements.

Disregarding the possibility (by no means remote) that the volume of aid (grants and loans) available to a country is made dependent upon its social policies, the major effect on *capital movements* is related to the plain fact that what is just for the poor is unjust for the rich. Progressive taxation, land reforms and nationalizations, all tend to foster capital outflows which may exert a heavy drain on the balance of payments. Certain developing countries specialize in being tax havens and the inflow of capital to such countries may be so heavy that they exhibit better growth performances than other less developed countries, with standards of life rising and mass poverty disappearing faster than in countries which deliberately pursue social justice policies and, for that reason, suffer from the flight of capital. This paradox should not be taken to imply, of course, that all less developed countries would be better off if they gave up social policies and became tax havens. Such a development would remove the need for tax havens which flourish only because they are exceptions to the rule.

Strong interference with wealth and income distribution may thus give rise to a need for control of private capital outflows, and such controls are only effective when all capital movements are controlled. But this in turn requires complete control of commodity exports and imports, and all other foreign payments, because export and import transactions offer the simplest way of evading controls on capital movements. This may be one of the more serious consequences of social policies in less developed countries. Policy measures should therefore be taken so that they minimize the incentive to capital flight. Redistribution of wealth through land reform or nationalization without compensation is probably much more conducive to capital flight than redistribution of income through progressive income taxation. And if such measures as land reform are thought to be socially necessary, they should be carried through quickly and decisively and in such a way as to remove apprehensions about similar future measures of this type. Nothing is probably

worse than half-way measures with the threat of confiscation hanging over the wealthy classes for long periods. Such situations may simply be destructive for the economy, paralysing or distorting private entrepreneurship, without, in any way, improving the position of the poor and the disadvantaged.

In relation to *commodity trade*, the problem is whether the composition of domestic demand and supply will affect exports and imports so as to imply a change in the balance of trade. It is assumed that the effect on total effective demand has been compensated for through adjustments of public saving. The question is then how the direct and indirect content in consumption of exportables and actually imported goods depends on distribution of consumption, or, to put it in another way, how the content of strictly domestic (non-traded) goods and services and import substitutes depends on distribution. Past and present policies of investment for import substitution have thus an important bearing upon the future balance of payments effects of income redistribution. In their import-substitution policies, a number of countries have directed their attention to actual demands from the higher income brackets, such as durable consumer goods of a sophisticated nature, rather than to potential demand from the lower income brackets for simpler and unsophisticated products. Past investment policies may thus prejudice income redistribution: to utilize existing capacity and keep up employment, and to prevent an increase in complementary imports, inequality of income may have been made a built-in necessity. What makes such a situation particularly perverse is that, whereas, typically, production of sophisticated consumer goods in less developed countries is highly non-competitive (even at "realistic" exchange rates), it stands to reason that production of simple consumer goods (non-durable and semi-durable) may be competitive, not only because less skill may be required, but also because the c.i.f. - f.o.b. price gap is relatively larger, the lower the value per unit of weight or volume, and the larger this price gap is, the more likely is it that the country will be competitive in the domestic market. Preference for foreign goods may also be lower among the lower income brackets, in particular among illiterates in rural areas: the demonstration effect is a typical urban, middle- and upper-class phenomenon. Equalization of income distribution may thus require a radical change in import substitution policies, a change which on the other hand is likely to have positive effects from a pure allocation point of view.

Only careful empirical analysis based on actual and potentially optimal import-substitution policies can tell what the ultimate demand effect of redistribution on the balance of trade will be; there is little

point in speculating about the outcome of such empirical analysis. The high food content in the consumption of the lower income brackets may be compensated for by higher direct or indirect import content in the consumption of the higher income brackets. The results will be highly dependent upon the degree of import control and the structure of domestic industry, but it could be mentioned that improved social services, including educational and health services, will tend to expand public demand for goods and services and (apart from defence) production of public services is relatively labour-intensive, with a relatively low direct content of imports and exportables.

Skills and abilities of labour and management

Unless equity considerations prevent adequate wage and salary differentials and thus promote a "brain drain", it is hard to see how policies for social justice could diminish the supply of skills. Equalization of opportunities should even be expected to have strong effects in the opposite direction. The problem of adequate wage and salary differentials is presumably most difficult to solve in relation to foreign competition (the "brain drain"): for here, competitive wages may imply domestic wage differentials that no political party would dare to endorse. For purely domestic purposes, wage differentials need not be very large; it may be the ranking, rather than the absolute differences which matters from the point of view of incentive. Moreover, people generally understand that skill is worth its price, and, for that reason, moderate differentials usually do not give rise to objections.

In some of the countries of this region, mass poverty results in malnutrition of large population groups. If malnutrition can be mitigated through redistribution of income, the following increase in the ability to work should make the potential returns of such redistribution very substantial. Whether this potential return will materialize depends, however, upon the precise way in which labour productivity is affected. If the improved nutrition only implies that a man is able to work longer hours, and the situation is one of absolute surplus labour (with zero marginal productivity), there will be no increase in production despite a greater ability to work. If, on the other hand, better nutrition implies increased productivity of labour, production will increase at a given employment, and, at given money wages, employment will tend to increase. Needless to say, the redistribution and improvement of nutrition is in any case highly valuable from a social point of view, no matter what its effect is on production.

C. Concluding Remarks

There is no denying that conflicts may arise between development targets and social justice targets, but the possibility and seriousness of such conflicts have been greatly exaggerated. The complementarity situation, in which the fulfilment of social justice requirements directly facilitates growth, may be less frequent than optimists would like to believe. Yet, there is no absolute contradiction, and trade-off may be entirely avoided or at least reduced through the adequate use of policy instruments.

There is a remarkable difference between the efforts made for developing methods of planning, and those devoted to developing methods of implementation. Typically, planners plan without considering constraints on implementation in any serious and detailed manner. Yet it is implementation that de-

termines the success of planning. More often than not, developing countries have simply tried to copy the fiscal and monetary institutions and instruments applied in developed countries rather than to design them from the very beginning for the environment in which they are intended to work. Developing countries would do well in reallocating some of their scarce resources of skilled and competent expertise from planning in the traditional sense of the word to design of institutions and instruments for implementation of policy targets. There are no simple short cuts to improvement and innovation in institutions and the technology of economic policy, but experience proves that, when resources are invested in this activity, returns in the form of better policy performances will follow sooner or later: what looks difficult and almost impossible today may be mere routine tomorrow.

Chapter II

ECONOMIC GROWTH AND EMPLOYMENT

In the developing countries, and especially in the ECAFE region, the task of seeking economic growth through rationalizing the factor mix and modernizing the state of technique while simultaneously seeking to improve living conditions by assuring the population at large a higher real income level has raised a number of fundamental conceptual and empirical issues. This chapter attempts to review some of these issues, to place them in a logical framework for further discussion, and to suggest a feasible and consistent policy orientation through which the developing countries of the ECAFE region may cope with the employment problem within the scope of their commitment to accelerating and sustaining economic growth.

The first section discusses briefly the relationship between employment and output as developed in economic theory. Section B reviews both the importance of employment as a development objective and the employment picture within the ECAFE region as a means of emphasizing the urgency of the problem. Section C examines past experience and future prospects of employment growth within the industrial and service sectors in the region and presents suggestions in favour of greater reliance on market prices and labour-intensive techniques in including fuller employment alongside further industrialization. Section D continues this discussion with specific reference to the agricultural sector, where the employment problem is especially critical owing to the various factors which inevitably coincide to produce a relatively low sectoral rate of growth and high rates of unemployment and underemployment. Some general conclusions emanating from these reviews and discussions of growth and employment are presented in Section E.

A. Employment and output as development policy objectives

A striking characteristic of labour is its double role in the economic process. On the one hand, it is a factor input; on the other, it represents the vast majority of the consuming public. In a strict economic sense, the labour force might be considered separate and distinct from the household sector. In this case, the problem of employment, unemployment and/or underemployment of labour would not differ from similar problems relating to under-utilization of

other factors of production. The "optimal" allocation of all factor inputs and opportunity costs would relate back solely to conditions of comparative advantage, deriving from the state of technique and the factor endowment.

Where labour serves as the sole source of income for the vast majority of the population, however, as is true throughout the developing ECAFE countries and the rest of the world today, the question of "optimal" resource allocation and social cost with respect to the labour input must include a consideration of questions of social welfare as well as economic efficiency. Careful attention must be paid to this seeming paradox with a view to ensuring a structure of the economy that can assure a high level of productive employment at some "reasonable" levels of wages and salaries. This goal has been reiterated as one of the major themes of the Second United Nations Development Decade, and it would be well to examine its implications briefly in the light of standard economic theory.

In a market economy, the level of employment is ordinarily fixed in accordance with marginal productivity considerations. That portion of the labour force whose marginal value productivity falls below the going money wage rate remains unemployed simply because it is not profitable for firms to use its services. In an economy where the level of unemployment is chronically very high, as in the developing countries, the mechanism that determines the employment level under competitive conditions may come in for considerable criticism on grounds of social justice, and various forms of social control over the market mechanism may be called for. In the developing economies, which, in addition, typically face a characteristic output problem, the question is whether the objectives of raising both output and employment levels can be attained in conjunction under enlightened development policies. It is important to examine this question more rigorously.

In an economic system containing only one sector and one technique of production, a fixed relationship will exist between output and employment, so that any increase in employment will require an increase in output, and *vice versa*. Extending this proposition to the aggregate level without distinguishing between sectors and postulating fixed factor proportions, we will usually find that, in developing

countries, the maximization of current income is consistent with some unemployment of labour. This result arises out of the abundance of labour and scarcity of capital and the proportions in which the existing technology is capable of combining these two factors of production.

Under the conditions presumed in such a society, employment can only be raised by increasing the capital input. There are, of course, two ways of doing so: through the importation of capital goods from abroad, and through the domestic accumulation of savings for transformation into capital goods. If capital becomes available in either or both of these ways, there need be no conflict between output growth and employment growth; in fact, the former will remain an essential condition for the latter.

However, if variability of factor proportions and sectoral differences in factor requirements are entered into the model as complicating (but more realistic) elements, this simple relationship between output and employment will no longer hold. If the proportions in which factors can be combined are assumed continuously variable, either within each sector or between sectors, output will be maximized by employing capital with the techniques and in the sectors using the highest labour input per unit of capital. The distinction between sectors (commodities) is particularly important here, because, by altering the sectoral composition of output, the amount of employment generated in the economy as a whole can be varied. And, if alternative techniques are available within each sector as well, the range of choice between labour- and capital-intensive production processes will be even greater. Indeed, with continuous variability in factor proportions and/or output composition, output can be raised so long as additional units of labour combined with the given capital stock yield a positive return. Alternatively, a given capital stock will produce the maximum output when it is so allocated among sectors and techniques as to permit the largest possible level of productive employment of labour.

While this reasoning indicates that there is no essential conflict between output and employment objectives, it does reveal a conflict between labour productivity, and, hence, wages and employment. The greater the ratio of labour to capital, the lower will tend to be the marginal and average productivities of employed labour. And *vice versa*, with a given capital stock, output per unit of labour will rise as employment of labour declines. This relationship is consistent with the fact that total output, and hence *per capita* income, will be higher where productivity

of labour is reduced as a consequence of increased employment. To put it differently, output per head of employed population will be lower with higher employment, but income per head of the entire population (including both the employed and the unemployed) will be higher; in the opposite situation, as total employment declines, output per head among the employed will rise, but income per head of the entire population will be reduced. Thus, there is a conflict between productivity of those employed and income per head for the population as a whole, and even more so between employed and unemployed. Under these circumstances, and in a free enterprise system (where profit considerations take first, if not sole, priority), there will tend to be considerable inequality in the distribution of income simply because the unemployed earn no income, and this inequality will be greatest in developing economies since they tend to have high unemployment levels. This condition may, of course, be ameliorated by resorting to various types of income transfer mechanisms between the private and public sectors.

In sum, when flexibility of factor proportions is introduced into the simple growth model, no inevitable conflict arises between the output and employment maximization objectives in the aggregate, although, on the micro level, profit goals will imply that employment be limited by labour productivity constraints. Given a relative scarcity of capital and abundance of labour at the macro level, a situation typical of the developing countries, it follows that both employment and output can be maximized through a heavy emphasis on labour-intensive techniques and sectors.

While the degree of labour intensity is limited by the available range of technological choice, there is also a limit to the extent to which the composition of output can be varied with a view to maximizing employment through the expansion of the labour-intensive sectors of the economy. This limit is set by the composition of demand for the output of different sectors. However, this constraint can be relaxed in the context of an open economy, because limits to the expansion of the output of a sector set by the extent of domestic demand can be overcome by export expansion. Similarly, the excess of domestic demand over the output of the shrinking sector can be met by import expansion. The limit, if any, to the expansion of markets through exports brings us into the realm of international economic policy of the importing countries as well as the structure of the export market and the nature of the demand for particular labour-intensive products. If exports face an inelastic demand, the fall in the export price and the consequent loss in real income may bring us back to a

conflict between the expansion of current employment and output.¹

To the extent that tariff and other barriers to world trade restrict the growth of labour-intensive manufactured exports from the developing countries (which incidentally appears to be confirmed by the existing commercial policy pattern in the developed countries), the promotion of employment in the poor countries will conflict with the objective of increasing output. In so far as the pattern of domestic demand limits the expansion of the output in the labour-intensive sectors or industries, it is conceivable that the pattern of demand be regulated by either direct or indirect controls with a view to diverting demand in the direction of the more labour-intensive products. This can be done by means of a fiscal policy which taxes labour-intensive products lightly compared with capital-intensive products. Moreover, a more equal distribution of income probably tends to direct the pattern of aggregate domestic consumption towards labour-intensive commodities, since a large part of the consumption expenditure of the lower income groups is spent on relatively unsophisticated consumer goods, which are usually produced by labour-intensive techniques. It therefore follows that a development strategy which concentrates on increasing output (and employment) in those sectors in which large masses of poor people are employed, such as agriculture, will stimulate the demand for labour-intensive consumer goods, such as food.

The absence of conflict between the objectives of maximization of current output and employment is based on the assumption that, with a more labour-intensive technique, output per unit of labour is lower and output per unit of capital is higher than in the case of a less labour-intensive technique. Since capital is here assumed to be the scarce factor of production, the choice of an appropriate technique should ensure that output per unit of capital will be higher than under any other alternative technique. This will maximize output with a given capital fund while at the same time employing the maximum amount of labour.²

¹ The phenomenon of inelastic world demand depressing export prices is more likely in the case of agricultural products than with industrial products; for example, if the export crop of a particular country constitutes the bulk of the world supply of the commodity, it influences the export price through variations in the export sales. This may also happen if all or many developing countries promote the export of labour-intensive agricultural products.

² If more capital-intensive techniques produce more output per unit of capital, while employing a smaller labour force, then a conflict arises between the output and employment objectives. In other words, where more labour-intensive techniques require more capital as well as more labour per unit of output, an inefficient technique arises from the technological point of view since more of both factors are necessary to produce the same output, and it should, therefore, automatically be ruled out of the range of choice.

This is an appropriate line of reasoning where selection must be made from among simultaneously available technologies on the basis of given factor prices. While obviously inefficient techniques will be ruled out if alternative superior techniques are presently available, the developing countries typically are confronted with technological sets or production surfaces which represent technologies belonging to different time periods. They are, in fact, endowed with capital stocks embodying technologies of different vintage. They are more often than not in a stage of transition from traditional to modern technology. Moreover, the more capital-intensive techniques are often associated with economies of scale, and therefore yield higher output per unit of both labour and capital. In cases such as these there is an inevitable conflict between maximization of output and employment. Such cases may, however, be limited in number. Moreover, in such conflict cases, the choice may require the policy-makers to attach relative weights to the output and employment objectives, assuming that cases of conflict are important enough and frequent enough to make an appreciable difference in the level of aggregate employment. It may happen that these capital-intensive activities are either supplied by, or through their products feed, industries that are intensive users of unskilled labour, so that, over the economy as a whole, their direct and indirect effects are both employment and output-generating. They may also generate scarce foreign-exchange resources with high opportunity cost or economize the services of factors even scarcer than capital, such as certain classes of highly skilled labour; in both cases, capital-intensive techniques justify themselves.

While the objective of maximizing output does not conflict with the employment objective except in the cases mentioned above, this is not necessarily true when the rate of growth of income is sought to be maximized. The rate of growth of income is a function of the rates of saving and investment. If current income originates in the labour-intensive sectors employing labour-intensive techniques, the rate of saving will be lower than it would be if income were generated in the capital-intensive sectors or by the use of capital-intensive techniques. This is so because, in the latter case, the share of profits in *income*, and hence the rate of saving, is higher. This is on the assumption that profit-earners have a much higher propensity to save than wage-earners, so that a pattern of distribution of income which heavily favours savers is conducive to a higher rate of growth. Since profit-earners are few and wage-earners are many, a high share of profits in national income implies an unequal distribution of income. This line of reasoning implies, firstly, that an unequal distribution of income is a prerequisite for a high rate of saving, and secondly, that an unequal distribution of

income is related to an investment in the low employment-generating techniques or the capital-intensive sectors.

This line of reasoning may be examined more closely. Even if it is true that profit-earners save more than wage-earners, investment in labour-intensive techniques or sectors does not necessarily lower the rate of saving. The amount of savings generated by the initial round of investment is a function both of the magnitude of increase in income and of the rate of saving out of the increase in income. When deciding in which sectors or techniques to employ the limited investment funds, it is necessary to take both these factors into account. The initial investment in a labour-intensive technique or sector may cause an increase in income large enough to offset the low saving rate out of the increase in income. In other words, the incremental capital-income ratio may be lower than the incremental saving-income ratio, so that the ratio of incremental saving to the initial investment is higher in the case of the labour-intensive techniques or sectors than in the case of the capital-intensive techniques or sectors. This is because, in the labour-intensive sectors or techniques, the increase in income per unit of investment is higher than in the capital-intensive techniques or sectors. Thus the higher incremental income may swamp the lower saving rate to generate a higher total amount of saving; it is the latter which is relevant to the future rate of growth of income. In view of this, the argument in favour of investment in capital-intensive sectors or techniques for the sake of generating a higher volume of investment funds needs serious qualification. The effect on the "reinvestment" coefficient of a given volume of initial investment in the labour-intensive techniques or sectors is an empirical question which needs proper quantification.

Secondly, it is necessary to analyse how far the inequality of income or the high ratio of profits in income is a precondition of a high rate of saving. In the first instance, this line of reasoning applies to private saving and not to total saving, including public saving. A more equally distributed national income may generate a higher rate of saving if fiscal policy is more efficient in squeezing saving out of such an income distribution. To suggest that the bulk of savings may be generated in the public sector does not imply, however, that investment needs to be nationalized. A preponderant share of public saving in national saving is quite consistent with a large volume of private investment, if public savings are channelled to private entrepreneurs or investors. In fact, in many developing countries, private investment is financed to a considerable extent by loans

and credits from publicly-sponsored financial institutions, dispensing funds derived from public saving. That it is politically difficult to raise the rate of saving through fiscal policy is not denied, but to suggest that it is politically easy to raise the rate of saving by means of an unequal distribution of income associated with high unemployment, especially in view of a growing public awareness of the problems of both unemployment and poverty in recent years, is unrealistic. The unemployed labour force is increasingly demanding social welfare measures for the alleviation of their poverty; any attempt to alleviate their condition will necessitate expenditure of public funds, reducing the volume of public saving and hence total domestic saving, even if the private savings of those who receive high incomes remains high.

Thirdly, recent experience has demonstrated that the opening up of new investment opportunities and high returns from such investment bring forth high rates of saving from relatively low- or middle-income earners when saving and investment decisions are combined in the same hands. This has been the experience with the increase in investment by farmers in new agricultural technology, financed out of their own savings once the high profitability of such investment was demonstrated to them. This may suggest that, if a high rate of saving is to be generated out of a more equally distributed national income, it may be useful to generate wider access to investment opportunities among a larger population than is the case with a highly unequal pattern of income distribution.

Empirical data on the sources of private savings by income stratum and occupational group in the developing countries are not adequate to allow any clear-cut verification of the relation between saving and income distribution, whether personal or factorial. Most data on corporate saving show high rates of reinvestment of corporate profits, even though one finds it difficult to assess the degree of underestimation of profits, which tends to yield an exaggerated picture of the saving rate. Moreover, saving and investment in the non-corporate sector, as well as in the self-employment sector, which includes agriculture and small-scale industry in developing countries, is considerable; corporate saving is a small proportion of total domestic saving. Empirical knowledge on the relationship between the distribution of personal income and personal saving is far from satisfactory. It has also been suggested that an unequal distribution of income may in fact reduce savings by pushing upward the consumption function of the lower-income groups, who tend to imitate the consumption habits of the rich. Moreover, a more

equal distribution of income may provide greater incentives for hard work on the part of the labour force and, in cases where standards of nutrition are very low, increase the productive capacity of workers.

The moral of the foregoing propositions appears to be that the rates of saving and investment which can be generated in an economy have been linked with the criteria of investment allocation between alternative techniques and sectors to an exaggerated extent, without adequate empirical foundation for the underlying behavioural relationships which must be introduced into such an analysis.

With a given income and a given income distribution, the amount of saving which can be realized is often affected by political decisions as to the policy instruments to be used, and this is a function of political will and of the determination to use the instruments effectively once a decision is made. Saving implies that, somewhere in the economy, some group has to undergo a sacrifice of consumption; the decision as to who is to bear the burden is a political one. To have the unemployed bear the burden, as is the case with investment in capital-intensive sectors or techniques, is no less a political decision than to have the employed bear the burden via increased taxation. Similarly, to rely on private saving as the main source of investment is not necessarily more efficient than to rely on public saving, combined with widely dispersed, private investment activities throughout the economy.

Unfortunately, the experience of the developing countries does not provide enough empirical evidence to resolve the issues raised here. To suggest that there are a number of developing countries which have in recent years attained a high rate of growth of output as well as of employment, with an increased emphasis on a labour-intensive technology, does not necessarily indicate a resolution of the conflict between employment and output as objectives of development strategy. The fact that they have attained a high rate of both employment and output does not eliminate the possibility that they could have grown faster if they had allowed employment to lag behind. The possibility of trade-offs may have been there even though no conscious decision was taken to choose between the two objectives. This could be due primarily to the fact that, since the rate of output growth was comfortably high, there was no desire to sacrifice employment considerations to accelerate further the rate of output growth. But the preceding analysis suggests that there has probably been more complementarity than conflict.

It is important to note in this context that a strategy of development which advocates concentra-

tion on the growth of output via investment in capital-intensive sectors or techniques does not imply a permanent neglect of employment as an objective for all time to come. The relative neglect accorded to the employment objective by this strategy is only a short-run phenomenon. To the extent that a higher rate of growth leads to higher rates of saving and investment, there will be a future increase in output and employment. The attainment of the employment objective is thereby only shifted to a future time horizon, the conflict between output and employment growth disappearing in the long run. Since current employment is sacrificed in order to increase the rate of growth of output and hence the rate of growth of employment in the future, the choice boils down to high employment growth in the future at the expense of current employment. Whether such a choice is socially desirable depends on the social rate of discount between future and present employment.

B. The dimensions of the employment problem in Asia and the Far East

Importance of employment as a development objective

As one scans the history of thinking on the problem of employment and unemployment in the recent past, one detects several stages in its evolution. There was, first, a time when there was a single-minded concentration on economic growth, i.e. a higher growth rate with enough "trickle down" to expand employment, perhaps even to achieve full employment. Recent calculations regarding the rate of growth of output, consistent with "full-employment" rates of growth of employment, yield very high figures which appear, at first sight, totally beyond the realm of achievement in the foreseeable future in any of the developing countries. For example, a model designed to estimate the rate of increase in gross domestic product required to absorb the increase in labour force in non-agricultural jobs yields the following results:³

	Per capita income (US dollars)	Rate of growth of population	Required rate of growth of gross national product (GNP)
(in percentages)			
Typical Asian country . . .	100	2.5	10.2
Typical Latin American country	300	3.1	9.3
Typical African country . .	100	2.7	11.0

³ Singh, S. K., "Aggregate employment function: Evaluation of employment prospects in LDC's", paper for Basic Research Centre, International Bank for Reconstruction and Development December 1969.

The above extremely high rates of growth, it should be emphasized, would only employ the natural increase in the size of the labour force but would not decrease the absolute number of people working on the land, nor would they affect the existing backlog of unemployment and underemployment.

The second stage in the evolution of thinking on the problem of employment and unemployment also assumes no major parameter shift in the behavioural relations of the system. It suggests, however, that, after the traditional planning exercise has been consummated, a "supplementary strategy" must be resorted to in order to mop up the remaining unemployed. This customarily means instituting labour-intensive public work programmes in either the rural or the urban areas. This approach, although its employment-generating potential is not negligible (especially if such a programme is buttressed by adequate technical assistance and necessary institutional and administrative infrastructure), fails to make employment a primary component of the development strategy; rather, it relegates it to an afterthought.

At the most recent stage, which has been reached in the 1970s, especially since the inauguration of the Second Development Decade with its concern for employment and income distributional problems in the developing countries, attention has been turned to exploring for ways of combining employment and output maximization policies as integral parts of the over-all development strategy.

The increasing concern with the problem of unemployment in the developing countries in recent years is traceable to a number of factors. Basically, there is the increasing realization, based on the experience of the recent past, that there is a substantial and increasing number of people who are unable to maintain an adequate living standard on the basis of the employment opportunities available to them. This is due, first, to the rapid growth of the labour force, a result of the population explosion in the developing countries. It is due, secondly, to the fact that modern-sector employment, especially manufacturing employment, has neither absorbed in the past nor, on the basis of present trends, can be expected to absorb more than a small part of the labour force. Thus, as more empirical studies of income distribution, family expenditure and dietary surveys become available, it is increasingly apparent that large groups of people experienced no improvement in the standard of living in the First Development Decade and may even have become worse off, despite the regional rate of growth of GNP at 5 per cent or more per annum.

Lastly, there is growing evidence of open urban unemployment. Despite widespread urban unemployment, the cities are growing rapidly, partly because of considerable immigration, and already account for a significant fraction of the total population in many ECAFE countries. While the above-mentioned empirical factors explain the changing attitude and increasing concern with unemployment, there are important logical factors, as well, explaining why employment objectives should constitute an important component of development strategy. The reasons, as stated in a recent monograph,⁴ are as follows:

- (a) A considerable volume of unused labour constitutes an important potential productive resource for a poor country and should be brought into use.
- (b) Employment in productive jobs provides opportunities to learn work skills and attitudes that are an integral part of the modernization process.
- (c) Location of good jobs and incomes determines to a great extent the population movements in developing countries.
- (d) Unemployment, especially urban open employment, among the young and active, causes frustration and tends to break out into violence.
- (e) In the absence of social security systems in developing countries, productive employment is the central mechanism for alleviating poverty.
- (f) Although the distribution of income in developing countries is often very unequal, the scope for a redistribution of income is severely limited by fiscal inefficiencies and the lack of political power sufficient to redistribute the ownership of income-generating capital. Since this is so, it follows that the only chance of improving the income of poorer groups is that of raising the standard of their employment.

Moreover, idleness and poverty are both morally repugnant and politically dangerous. All the foregoing reasons and circumstances render the pursuit of fuller employment a highly important objective of development strategy.

⁴ Shaw, R., *Jobs and Agricultural Development*, Overseas Development Council Monograph No. 3, Washington, D.C., 1970, p. 2.

Labour force structure and growth⁵

The fact that, for the periods 1950-1960 and 1960-1970, the net addition to Asia's population has been estimated at some 250 million and 400 million, respectively, suggests the magnitude of the employment problem emerging from the Asian population explosion. The critical nature of the situation appears in even more vivid dimensions when the prospects of future increases in population in the ECAFE region as a whole are specified: the "medium variant" estimate is that total population will grow from 1,600 million in 1960 to 2,496 million in 1980.⁶ Although the population growth prospects of individual Asian countries show considerable degrees of divergence from the regional average, it would appear that most of the ECAFE countries, having entered a critical phase of sharply accelerated population growth, are engaged in what amounts to a major demographic revolution without precedence in world history.

⁵ Based on Mehta, M. M., "Employment Problems, Prospects and Policies in Asia During the Second Development Decade (1970-1980)", Fifth Inter-regional Seminar on Development Planning, Bangkok, 1969, pp. 2-12.

⁶ "Medium" population projections prepared by the United Nations in *Population Prospects 1965-1985 as Assessed in 1968*, United Nations Population Division Working Paper No. 30, December 1969, and *Population Estimates by Regions and Countries, 1950-1960*, United Nations Population Division Working Paper No. 31, May 1970. According to revised United Nations estimates, Asian population will increase from 1,552 million to 2,465 million, during 1970-1980. ILO, *Progress Made with the Asian Manpower Plan*, Geneva, 1971.

An associated characteristic of the region's current demographic situation is the population's young age structure. In most Asian countries, the proportion of the population under 14 years of age constitutes between 40 and 50 per cent of the total, whereas in the industrialized countries it is 25 per cent or so. It is expected that the economic dependency burden is likely to increase rather than decline by 1980 in most ECAFE countries. According to recent estimates made by the ILO, the total Asian labour force will grow from a 1960 base figure of 735 million to about 863 million in 1970 and 1,036 million in 1980.⁷ This implies that roughly 173 million new jobs will have to be provided during 1970-1980 (as against 130 million during 1960-1970) simply to absorb the new entrants into the labour force. Also new employment opportunities will certainly have to be created to absorb the masses of unemployed and underemployed. The absorption of labour force increases of such a magnitude into productive employment poses a challenging problem to economic planners and policy-makers. The dimensions of the problem as seen by planners are revealed in table 1-2-1, showing employment targets as stated in selected plans.

⁷ "World and regional estimates and projections of labour force, 1950-2000", *United Nations Interregional Seminar on Long-term Economic Projections for the Whole World Economy*, Elsinore, Denmark, August, 1966. See also "Population growth and problems of employment", in *United Nations Economic Bulletin for Asia and the Far East*, vol. XII, No. 2, September 1961, pp. 1-19.

Table 1-2-1. EMPLOYMENT TARGETS IN THE DEVELOPMENT PLANS OF SELECTED ASIAN COUNTRIES

Country	Period	Total employment increase	Sectoral distribution of employment targets (in percentage)		
		(in millions)	Primary	Secondary	Tertiary
Ceylon	1959-1968	1.33	32.5	34.0	39.2
India	1956-1961	9.4	21.3	35.1	43.6
	1961-1966	14.0	30.0	27.8	42.1
Iran	1968-1972	0.97	23.4	43.2	33.4
Japan	1964-1968	1.53	-57.9	84.8	73.1
	1967-1971	4.60	-51.0	84.3	66.7
Korea, Rep. of	1962-1966	0.73	54.0	26.1	19.8
	1967-1971	1.28	34.4	28.1	37.5
	1972-1976	1.85	-16.8	44.1	72.7
Malaysia	1960-1965	0.34	41.2	29.4	39.2
	1966-1970	0.38	43.8	18.0	35.5
	1971-1975	0.60	—	—	—
Pakistan	1960-1965	2.6	53.8	26.9	19.2
	1965-1970	5.5	46.0	29.0	25.0
Philippines	1960-1967	2.7	4.2	50.2	45.5
	1966-1970	1.8	39.2	27.6	33.3
	1971-1974	3.4	45.0	21.0	34.0
Thailand	1967-1971	2.2	48.1	17.0	34.9
	1972-1976	2.6	59.7	5.9	34.4

Source: National development plans, as partly summarized by Mehta, M. M., "Employment Problems, Prospects and Policies in Asia During the Second Development Decade (1970-1980)", Fifth Inter-regional Seminar on Development Planning, Bangkok, 1969, table 7.

Several factors other than rapid population growth may tend to increase the size of the labour force in the developing ECAFE countries. The most important of them are: a growing female labour force due to the evaporation of social barriers and greater availability of wage employment opportunities; increased geographical, social and occupational mobility as a result of the opening of the hinterlands and the fall of institutional constraints; the growing pressure of various "pull" and "push" factors which account for rural-urban migration and changes in work attitudes and habits. Part of this increase will probably be off-set by such countervailing factors as the withdrawal of children from the labour force with the expansion of schooling, legal restrictions on the employment of young persons, increased earnings and associated social changes which tend to keep the female participation rate low, and reduced participation in consequence of a greater measure of social security in the form of old-age pensions, workmen's compensation and social assistance to the physically handicapped. In spite of such reductionist pressures, the labour force will in all likelihood continue to increase at a faster rate than the population.

³⁵
Labour force distribution by primary, secondary and tertiary economic sectors is an important indicator of the level and pattern of economic development; not only does it indicate whether the type and pattern of the national economy is agrarian, semi-industrial or industrial, but more importantly it characterizes the type and pattern of changes that tend to occur in the structure of the labour force during the period of economic growth, thus permitting structural prediction and planning. The distribution of labour by major economic sectors in the developing ECAFE countries suggests its predominantly agricultural character, the relatively high proportion of persons engaged in the services sector compared with industry, and the lack of diversification in the economic structure. Available data permit us to estimate that about two-thirds of the labour force of the developing ECAFE region is engaged in agricultural production, one-fifth in services and one-tenth in industry.⁸

A related feature of the region's developing economies is the relatively small labour force engaged in professional, technical and other "cerebral" occupations. Whereas the proportion of professional, technical and related workers to total labour force in developed countries averages between 8 and 12 per cent, it is only around 1 or 2 per cent in most developing ECAFE countries. The relative size of this

group is a useful indicator of the stage of economic growth and degree of diversification and sophistication of a country's manpower endowment. Another characteristic feature is the low proportion of wage and salary earners in the total labour force, particularly in rural areas. The size of the industrial wage-earning group is of particular significance, both for the mobilization and utilization surplus manpower resources and for the formulation of appropriate wage and employment policies. In sum, labour force structure is certain to undergo significant changes during the transition from agricultural to semi-industrial and later from semi-industrial to industrial output predominance, but this is of course ending the discussion with a truism.

Unemployment and underemployment

It is possible that Western concepts of employment and unemployment are inappropriate for use in developing countries. This results partly from the fact that wage employment, the characteristic form of employment in the developed countries, forms only a relatively small part of total employment in the less developed world. A high proportion of the working population in most developing countries is engaged in subsistence agriculture (in addition to small-scale trading and other tertiary activities) where family work-sharing rather than labour-hiring is the norm. Thus, employment in this sector can be extended to cover more people than absolutely essential through work-sharing and will usually absorb that part of the labour force redundant to modern sector requirements and which is not unemployed full time in urban areas or as a landless agricultural proletariat. For this section of the population, therefore, work and income tend not to be regulated by contract, so the idea of "employment" in the usual sense of the word does not apply. It is generally only in the so-called modern sector of these countries that there is institutionalized wage employment, but, with some exceptions, this involves only a small part of the work force.

The measurement of unemployment and underemployment is directly related to the concepts used to define the state of unemployment and underemployment. One definition often considered to cover the unemployed and underemployed labour force refers to it as those members of the population either seeking work or seeking additional work at going wage rates. Where differences in hours worked and in labour efficiency are small, the ratio of persons employed to the sum of those seeking work plus those at work and seeking work provides a reasonable indication of under-utilization of labour resources, at least in the short term. This is still true where variations in hours worked and labour efficiency are wide,

⁸ The ILO has recently estimated that three-quarters of Asia's 1970 population was rural and that, despite the fact that this percentage will drop only slightly by 1980, the urban population will grow by 4.4 per cent annually; *Progress Made with the Asian Manpower Plans*, op. cit., p. 6.

if the characteristics of the group seeking work are similar on average to those at work (that is, if the group seeking work is made up of people on average as efficient as people at work and who seek on average the same amount of work as is being done by those at work). It must be conceded immediately that these conditions are so stringent that, even in developed countries, the index of unemployment is not a very good indicator of the state of utilization of labour resources; the allocation of work among those who want it is clearly not a random process, so that those at work are usually on average superior in efficiency to those who are seeking it.⁹

Alternatively, unemployment provides a measure, in a very special and restricted sense, of the social adequacy of employment opportunities; given the terms at which work is exchanged for income, unemployment indicates the extent to which individuals are prevented from satisfying their preferences at these terms.¹⁰ Those who are prevented from working at all (the full-time unemployed) are particularly disadvantaged, and calculations relating to this group therefore are especially significant.

Unfortunately, the measurement of unemployment is not an easy matter in the developing countries, nor in any case can one be confident about the estimates available. In general, there are no usable unemployment statistics. What one gets is often the product of some public activity. Employment exchange records, for example, are often used as proxies, but they are almost useless as there seems to be no important developing country for which an effective policing system ensures either that the unemployed place their names on the register or that those finding employment take their names off the register (though the automatic elimination of those not re-registering is sometimes used). Most schemes of this kind are voluntary, and many mix registrations of those in employment with those seeking better employment.¹¹ In practice, therefore, almost all that is known about unemployment is derived from employment registers, sample surveys, and census data.

Some interesting findings do emerge, however, from an analysis of the structure of unemployment as revealed by sample surveys, and, for this purpose, the range of countries is significantly broad since

there are a number that have made one or more special inquiries. In particular and seemingly invariably, open unemployment is higher, and usually much higher, in urban than in rural areas. In countries where the "not seeking but available for work" group are counted as unemployed, unemployment rates seem mostly to be in the range of 10-15 per cent in urban areas but only 2-5 per cent in rural areas. Also, in countries for which detailed data are available, unemployment rates are much higher in the younger age groups (say, 15 to 24 years of age), and partly in consequence a considerable proportion (50 per cent or more) of men tend to be unmarried and not heads of households, while for both sexes a large number (again often around 50 per cent) have no previous work experience. Another feature that has attracted considerable attention is that the unemployed are relatively highly educated, partly because they are young and partly because, even in relation to their own age groups, the unemployed often include proportionately more secondary school leavers and fewer illiterates.

Since agriculture is the largest and poorest sector of the labour market, almost all survey efforts of this kind start there, and considerable underemployment is usually found. Because of seasonal variation, however, a part, and in practice usually the greater part, of the underemployment uncovered is seasonal; most underemployed agricultural workers are locked into agriculture by the need to be present at planting or harvest time. One study on the Republic of Korea, for instance, indicates that, in total, 30 per cent of work time, a large part of it seasonal, was unutilized.¹²

All methods of estimating the labour force surplus revolve on the wider or narrower interpretation of "men working efficiently." A first and comparatively weak assumption is that "men working efficiently" means men working full time, with the important loophole that no assumption is made about the surplus being available at going wage rates. Thus, if reference is shifted to a more "reasonable" standard, say men working half-time or more, the labour surplus in relation to men at work diminishes by up to 50 per cent. In this case, however, the problem of seasonal versus other forms of labour surplus raises its ugly head. In contrast with the involuntary unemployment approach, the standard here is frankly normative and will probably be related to some specified income level.¹³

⁹ Except when rates of unemployment are very high. Almost all the recent writing in the context of developed countries, where rates are low, treats unemployment as mainly a social problem.

¹⁰ Unemployment covers anyone unemployed who would be as efficient at a job as someone actually doing it and who would accept the same wage if it were offered him.

¹¹ For details of the statistics collected by the ILO and published in the *Yearbook of Labour Statistics*, see the *Technical Guide to Statistical Series*, vol. 11(1).

¹² Cho Y. S., *Disguised Unemployment in Underdeveloped Areas* (University of California Press, 1963).

¹³ In dealing with agriculture, a sometimes convenient variant defines the labour surplus not directly by a comparison between time worked and standard time, but as a relation between adequate sized holdings and existing holdings.

A considerably stronger assumption converts standard men into efficient men, as well as at full-time work; qualitative differences arising from better health, improved diet and motivation may be allowed for to account for differences in product per man hour. This approach draws attention to the undoubted fact that an important group of very poor workers, not only in services and handicrafts but in agriculture too, work very long hours for very little return. It can also, stretching a little, be made to cover the effects of cultural or sociological inhibitions on work practice.

Thirdly, in addition to or apart from the cases already discussed, "men working efficiently" can refer to the framework within which activities are organized. Again, wider or narrower interpretations are possible, but, in principle, any change in the organization of factors available or factors potentially available through the market is legitimate — covering land reform, substitution of fertilizer for bullocks, elimination of monopolistic middleman, and so on.

Starting out from different assumptions, it is possible to produce a variety of types and degrees of labour surplus any one of which may constitute a useful and interesting way of looking at the specific problem in hand. In particular, measures of the first kind (a surplus equivalent to less than full-time working) focus attention on important problems. It is undoubtedly true, for example, if population pressure reduces individual work time through work sharing, that relieving the pressure through taking labour off the land or out of the rickshaw ranks will encourage extra work and generate extra income for those who remain. Where a growing stock of work-people faced with unchanged production possibilities is a key problem, as is increasingly the case in many developing countries, in fact, "surplus labour" describes an important aspect of reality. In practical application, however, it turns out not at all easy to measure this kind of surplus because, in addition to the reasons already discussed, it is difficult to simulate how a reduced number of full-time workers would affect the organization of work and the institutional framework. Nor does this method indicate how much more work will be forthcoming as income possibilities are increased, or alternatively, how big the earnings change must be to produce a given increase in work.

Neither the involuntary unemployment nor labour surplus approaches to the unemployment problem are altogether satisfactory indicators for assessing the over-all magnitude of the employment problems in developing countries. Involuntary unemployment data undoubtedly provide us with information about a politically sensitive and economically important

group of dissatisfied workers, and they probably also, especially in a trend sense, provide some indication of the over-all employment situation in urban areas. However, it does not deal with the problem of low income among large groups of employed workers. The surplus labour approaches are much better in the latter respect; they need to be supplemented, however, with direct and repeated inquiry based firmly on questions of income and the circumstances in which income is derived.

Some empirical evidence on unemployment and underemployment¹⁴

In Ceylon, according to a comprehensive survey carried out in 1959-1960, the unemployed constituted about 12.5 per cent of the total labour force,¹⁵ and a more recent (1965) estimate puts the figure at 13.5 per cent.¹⁶ In India, the total number of unemployed persons at the beginning of the draft fourth five-year plan was estimated to be around 9-10 million, and the net addition to the labour force was projected to be in the order of about 23 million during the plan period.¹⁷ The total additional employment opportunities likely to be generated during the draft plan period were estimated to be of the order of 18.5-19 million, indicating that the backlog of unemployed at the close of the period was to be around 13-14 million. This draft plan has not been taken up for implementation, and the new draft plan (1969-1974) gives no estimate of the current backlog of unemployed in India. In Indonesia, the 1961 Census showed an over-all national unemployment rate of 5.4 per cent (4.8 per cent among males and 7 per cent among females), and in 1970 the rate was estimated to be about 10-11 per cent of the labour force.¹⁸ In Iran, the number of unemployed persons in 1962 was estimated to be of the order of 300,000, nearly 5 per cent of the total labour force,¹⁹ and the 1966 Census estimated the unemployment rate (including the seasonally unemployed) at around 9.1 per cent. In the Republic of Korea, the number of unemployed in 1967 and 1971 were estimated at 590,000 and 480,000, respectively, constituting about

¹⁴ Based partly on Mehta, *op. cit.*, pp. 13-17. For further recent statistical findings see ILO, *Progress Made with the Asian Manpower Plan*, *op. cit.*, pp. 9-12; and Asian Institute, *Framework of an Employment-Oriented Development Strategy in Asia*, Bangkok, 1972.

¹⁵ "Survey of employment, unemployment and underemployment in Ceylon", *International Labour Review*, March 1963.

¹⁶ ILO, *Report of the Director-General to the Sixth Asian Regional Conference* (Geneva, 1968), p. 31.

¹⁷ Government of India (Planning Commission), *The Fourth Five-Year Plan — A Draft Outline* (1966-1971), pp. 106-108.

¹⁸ Asian Population Conference, New Delhi, December 1963, Country statement: Indonesia; and Ninth National Convention of Gasbiindo, Semarang, Indonesia, 1970.

¹⁹ Government of Iran, Planning Organization, "Third Plan Framework (1962-1968) — Manpower", 1961, mimeo., p. 95.

6.2 per cent and 4.5 per cent of the total labour force in the two respective years.²⁰ In Malaysia, a comprehensive survey of employment, unemployment and underemployment (carried out in 1962 in the former Federation of Malaya) showed a moderately high rate of unemployment, viz. about 6 per cent of the total labour force (5.2 per cent among males and 7.9 per cent among females).²¹ The first Malaysian plan (1966-1970) and the manpower survey conducted in 1965 in the State of Malaya also estimated the unemployment rate to be around 6 per cent.²² The plan projected a rate of growth of employment of 2.8 per cent per annum, or the creation of some 380,000 new jobs during the five-year period. According to the Government, "it is not likely that this rate of growth in employment has in fact been achieved during the period under review."²³ For Nepal, one study has estimated "that nearly 2 million workers could be drawn from the hills for employment in non-agricultural sectors of the economy."²⁴ In Pakistan, over-all unemployment appears to be around 7.5 million man-years, which means that nearly 20 per cent of the labour force would be idle if the rest were fully employed.²⁵ In the Philippines, the number of totally unemployed persons (which was estimated to be around 739,000 in 1959) rose to 950,000 in 1965, constituting 8.2 per cent of the labour force.²⁶ According to the same source, if the current backlog of unemployed were to have been converted to an equivalent number of fully employed, the unemployment rate would likely have been of the order of 12-13 per cent of the labour force.²⁷ The principal conclusion which emerges from these scattered quantitative estimates is that the incidence of unemployment is widespread among the developing countries of the Asian region.

Quantitative estimates on underemployment are far scarcer and less conclusive. In India, the number of underemployed, in the sense of those who have some work but are willing to take up additional work,

has been estimated to be of the order of 15-18 million.²⁸ In Indonesia, disguised unemployment is estimated to be in the range of 12 to 15 million, which means an investment increase of US\$4 million (40 per cent of GNP) would be required to furnish them with jobs.²⁹ In the Republic of Korea, the number of underemployed has been estimated at 2.2 million — nearly 26 per cent of the total labour force.³⁰ In Pakistan, rough estimates indicate that underemployment in rural areas amounted to approximately 5 million idle man-years in 1959 and was likely to have been of the order of 9 million in 1965.³¹ In the Philippines, underemployment has been estimated to be equivalent to nearly 550,000 fully unemployed persons on the basis of a 40-hour week.³² These statistics furnish only a glimpse into the magnitude of the underemployment problem in the developing ECAFE countries.

C. Industrial development and employment

The formulation of a sound development strategy for realization of the employment objective during the 1970s would require a preliminary assessment of the relative roles of the different sectors of the economy as sources of employment as well as the choice of techniques in each sector. The classical assumption that a changing economic structure away from the traditional, rural, agricultural sector towards the modern, urban, industrial sector will necessarily eventually provide expanding employment opportunities for the growing labour force has not been found to be realistic. Over the last decade, output growth in the modern sector has not been associated with employment growth to a proportionate extent. In the light of this fact, it is necessary to examine the past experiences and the future employment-generating potentials of the various sectors of the economy; on the basis of this assessment, the choice of techniques in each sector needs to be explored carefully.

In the past decade or so, most of the developing ECAFE countries have achieved significant rates of industrialization accompanied by varying degrees of success in achieving a high rate of growth of GNP. In many countries, the performance of agriculture has

²⁰ Republic of Korea, Economic Planning Board, *The Economically Active Population Survey*, 1967, Seoul, 1968; and *idem*, *The Third Five-Year Economic Development Plan 1972-1976*, 1971, p. 160.

²¹ Government of Malaya, *Report on Employment, Unemployment and Underemployment*, 1962, pp. 8-15.

²² Government of Malaysia, *First Malaysian Plan 1966-1970*, p. 53, and *Report of Manpower Survey*, 1965, State of Malaya, prepared by United Nations Statistical Adviser, p. 45.

²³ Government of Malaysia, *Mid-term Review of the First Malaysian Plan, 1966-1970*, p. 16.

²⁴ Thapa, B. B., *Planning for Development in Nepal, A Perspective for 1965-1980*, 1960, p. 100.

²⁵ Government of Pakistan, *The Third Five-Year Plan 1965-1970*, p. 25.

²⁶ *Four Year Economic Programme for the Philippines, Fiscal Years 1967-1970*, Office of the President of the Philippines (Manila, September 1966), pp. 7-8.

²⁷ *Ibid.*, p. 8.

²⁸ Government of India, Planning Commission, *Third Five-Year Plan* (Delhi, 1961), p. 158.

²⁹ Sumawinta, Sarbini, "Country Report for Indonesia", Sixth International Forum "One World Only", Tokyo, November 1971, p. 2.

³⁰ Republic of Korea, Economic Planning Board, *Economic Survey 1963*, p. 147.

³¹ Government of Pakistan, *Outline of the Third Five-Year Plan (1965-1970)*, 1964, p. 13.

³² Republic of Philippines: *Four Year Economic Programme for Philippines (1967-1970)*, 1966, p. 8.

not been satisfactory, except recently in a few countries benefiting from the spread of new agricultural technology. This section and the following one examine the past experience and future prospects of employment growth in these sectors.

*Manufacturing growth trends and employment*³³

That employment growth has not responded to the growth of output in the manufacturing sector is seen in table I-2-2, which shows the employment-output ratios for total manufacturing as well as for

individual manufacturing industries.³⁴ The most interesting and important characteristic of these trends is the sharp and unremitting decline in the employment-output ratios in all groups of manufacturing. This trend is reflected in both light and heavy manufacturing, although the decline in employment-output ratios is much sharper in the latter. The employment-output coefficient for total manufacturing declined to 0.49 in 1966 for the ECAFE region and to 0.69 for the world from the 1955 base year. For heavy manufacturing, the employment-output coefficient showed a somewhat sharper decline to 0.42 in 1966 for the ECAFE region and 0.66 for the world from the 1955 base year.

³³ Based on Mehta, M. M., "Employment Aspects of Industrialization (with Special Reference to Asia and the Far East)", Asian Conference on Industrialization, ECAFE, 1970, pp. 6-22.

³⁴ That this problem is likely to continue is noted by the ILO, see *Progress Made with the Asian Manpower*, op. cit., pp. 9-10.

Table I-2-2. INTERRELATIONSHIP BETWEEN OUTPUT AND EMPLOYMENT
IN MAJOR GROUPS OF MANUFACTURING INDUSTRIES FOR
WORLD AND ECAFE REGION, 1955-1966

	Employment-output ratio							
	1955	1958	1960	1961	1962	1964	1965	1966
Total manufacturing								
World	1.00	0.94	0.85	0.84	0.81	0.75	0.72	0.69
ECAFE region	1.00	0.83	0.69	0.63	0.60	0.56	0.54	0.49
Light manufacturing								
World	1.00	0.95	0.88	0.88	0.86	0.84	0.81	0.78
ECAFE region	1.00	0.90	0.81	0.78	0.76	0.74	0.72	0.67
Heavy manufacturing								
World	1.00	0.96	0.87	0.85	0.80	0.72	0.69	0.66
ECAFE region	1.00	0.81	0.64	0.50	0.54	0.47	0.47	0.42
Food, beverages and tobacco								
World	1.00	0.97	0.91	0.89	0.87	0.84	0.81	0.79
ECAFE region	1.00	—	0.96	0.91	0.89	0.80	0.76	0.71
Textiles								
World	1.00	0.94	0.86	0.83	0.80	0.77	0.75	0.71
ECAFE region	1.00	0.91	0.79	0.77	0.74	0.69	0.65	0.61
Clothing and footwear								
World	1.00	0.94	0.87	0.86	0.87	0.89	0.88	0.88
ECAFE region	1.00	—	—	—	—	—	—	—
Wood products and furniture								
World	1.00	0.96	0.88	0.85	0.82	0.79	0.78	0.76
ECAFE region	1.00	—	—	—	—	—	—	—
Paper and paper products								
World	1.00	0.96	0.91	0.88	0.85	0.78	0.74	0.73
ECAFE region	1.00	0.99	0.80	0.72	0.70	0.63	0.62	0.57
Chemicals and chemical, petroleum and coal products								
World	1.00	0.88	0.76	0.73	0.68	0.62	0.58	0.54
ECAFE region	1.00	0.78	0.66	0.66	0.61	0.55	0.51	0.40
Non-metallic mineral products								
World	1.00	0.89	0.79	0.78	0.73	0.67	0.65	0.61
ECAFE region	1.00	0.86	0.75	0.69	0.63	0.59	0.50	0.56
Basic metals								
World	1.00	1.08	0.96	0.97	0.92	0.82	0.79	0.76
ECAFE region	1.00	0.96	0.68	0.63	1.03	0.54	0.53	0.47
Metal products								
World	1.00	0.96	0.89	0.86	0.81	0.75	0.71	0.68
ECAFE region	1.00	0.71	0.55	0.40	0.44	0.38	0.30	0.34

Source: National censuses of manufacture, as derived by Mehta, M. M., "Employment Aspects of Industrialization (with Special Reference to Asia and the Far East)", Asian Conference on Industrialization, ECAFE, 1970, p. 6.

While the temporal pattern of employment-output coefficients has exhibited a clear downward trend in all the nine major groups of manufacturing industries, the decline has been most pronounced for chemicals and chemical products, petroleum and coal products, metal products and non-metallic mineral products. In the cases of light manufacturing in general, and of clothing, footwear, food and beverage and tobacco manufacturing in particular, the coefficient showed a more gradual decline.

In each of the nine countries of Asia for which comparative data on output and employment are available, the growth of manufacturing employment has lagged far behind the growth in manufacturing output. For example, in Japan, although manufacturing output increased by 3.5 times during the ten years between 1959 and 1968, manufacturing employment increased by only 1.5 times during the same period. In the Philippines, the growth in manufacturing employment during this period was 3.5 times slower than the growth in manufacturing output. In other countries also, the growth in manufacturing employment lagged behind the growth in manufacturing output. The intensity of the impact of industrialization on employment, however, varied considerably from country to country. There was furthermore a marked slackening in the rate of growth of manufacturing employment during the latter half of the 1960s in many countries of the region. It was accompanied by significant advances on the productivity front. This set of developments reflects the inverse relationship between rate of growth in manufacturing employment and rate of growth in manufacturing productivity; the faster the rate of growth in productivity, the slower the rate of growth in employment.

Detailed data on the employment-output ratio in Australia, Japan, and India reveal that the historical decline in this ratio appears to have been somewhat more pronounced in the heavy manufacturing industries, such as petroleum and coal products, chemical and chemical products, metal products, and non-electrical machinery than in the light manufacturing industries, such as leather and leather products, wood products, and food-processing industries. The trends, however, show significant intercountry and inter-industry differences in the behaviour of employment-output ratios, leaving regional averages less significant than some would have them. The decline in the ratios in heavy manufacturing, for instance, appears to have been much more pronounced in Japan than in India or Australia. This is also the case with some of the light manufacturing industries, such as textiles, paper and paper products, and rubber. The wood and furniture industries in Japan, on the other hand, appear to have become somewhat more labour-

intensive. In India, there has been a pronounced decline in employment-output ratios in tobacco, petroleum, metal products, non-electrical machinery, and transport equipment. The decline has been somewhat less pronounced in most of the light manufacturing industries. In Australia, there has been a marked decline in employment-output ratios in the petroleum, chemical, basic metal, and paper industries. In other industries, the decline has not been so pronounced. These differences emphasize the importance of viewing each case individually and also the danger of relying on regional averages as national policy guides.

Nevertheless, certain broad implications may be drawn from these historical trends from the standpoint of employment promotion in the manufacturing sector. For one thing, the declines in employment-output ratios in total manufacturing and in all the nine major groups of manufactures individually are indicative of the probability that the employment generating capacity of the manufacturing sector has declined considerably as a result, presumably, of the capital-intensive character of new investment and of significant advances in labour productivity. In addition, the restructuring of industrial output from light to heavy manufactures has tended to reduce the employment-generating capacity of this sector relative to output; regional trends in the growth of manufacturing output indicate that the output in heavy manufacturing has expanded much faster than output in light manufacturing, and this generalization appears to hold in the light of statistics for individual countries. Furthermore, the trend towards modernization and the application of science and technology to production processes appears to have progressed faster in the newly-established, well-organized, capital-intensive heavy manufacturing industries than in the comparatively traditionalist, less capital-intensive light manufacturing industries.

Experience suggests that structural changes in Asian manufacturing will have important effects on the rate and composition of growth of industrial employment. The impact of this growth on employment will depend primarily on the relative importance of different manufacturing industries in the national economies, the pace of manufacturing growth and changes in manufacturing employment-output relationships.

Structure of manufacturing employment

The relative share of different manufacturing industries in total manufacturing employment in selected countries of the region reveals two distinctive characteristics. The first regularity is the great

share of employment in light manufacturing, particularly textiles, food, beverages, and tobacco. The second and closely related regularity is the small share of the important heavy manufacturing industries, especially basic metals, chemical and chemical products, petroleum and coal products, and non-metallic mineral products. The two largest groups of light manufactures — textiles and food, beverages and tobacco — account for a total of 40 to 70 per cent of total manufacturing employment in many ECAFE countries, including Burma, Ceylon, India, Indonesia, the Republic of Korea, Pakistan, and Thailand. The relative share of heavy industries in total manufacturing employment varies between 20 to 40 per cent in most ECAFE countries. The only heavy industry which occupies an important place from the employment standpoint is metal products, whose relative share in total manufacturing employment runs between 10 to 30 per cent in many countries. An analysis of trends in manufacturing employment between 1959 and 1967 identifies those industries in which there has been a significant expansion in employment opportunities and those in which the situation has remained relatively stagnant. These major groups fall into the three broad categories of low, medium, and high employment-growth industries. Various labour-intensive, light manufacturing industries (mainly consumer goods industries such as textiles, clothing, wood and wood products) and some highly mechanized and capital-intensive industries (such as the petroleum, petro-chemical, and basic metals industries) stand out in the low growth category. The high employment-growth industries include various modern consumer-goods, intermediate and heavy capital-goods industries (such as electrical and mechanical equipment, heavy machinery, transport equipment, fertilizers, plastics, and artificial fibres).

Significant intercountry variations in the industrial-structure-of-manufacturing-employment trends must be considered. In India, manufacturing employment shows a downward percentage trend in the textile, leather and tobacco industries, and a significantly upward trend in the electrical and mechanical goods, iron and steel, heavy machinery, chemical and chemical products, transport equipment, paper, and rubber industries. In Pakistan, the percentage of manufacturing employment by industry shows a downward trend in the tobacco, clothing, and furniture industries but substantial gains in the electrical and mechanical goods, food and beverage, textile, leather, rubber, and paper industries. In the Philippines, a downward trend is recorded in the electric and mechanical goods, metal and non-metal, paper, rubber, leather, and printing industries, but upward trends appear in tobacco, beverages, and food-processing.

While trends in the growth of manufacturing output are reflected in the increased contribution of the manufacturing sector to the gross domestic product and in the changes in the relative contribution of the different sectors to total GDP, the same can not be said of employment. The pace of change is much slower, however, in low growth-rate countries, such as Ceylon, India, Pakistan and Indonesia, than in high growth-rate countries, such as the Republic of Korea and Thailand, but only in the fastest growing economies is a sizable dent in the manufacturing employment ratio being affected.

Placing these findings in general terms that permit policy interpretations, we may conclude that the impact of industrialization on employment tends to slow down as a country shifts from labour-intensive to capital-intensive techniques of production and from industries making relatively more use of labour and less of capital to those using proportionately more capital and less labour. The heavy emphasis now being placed on producer-goods industries, many of which are highly capital-intensive, and on heavy goods industries has tended to widen the gap between the growth of manufacturing output and the growth of manufacturing employment. It is, therefore, necessary to examine all opportunities of raising the level of manufacturing employment by bringing about a more labour-intensive product mix and a more labour-intensive technology mix wherever feasible and commensurate with considerations of economy and efficiency.

Choice of industrial technology

The past pattern of industrialization in the ECAFE region has not encouraged labour absorption into industrial employment. This has been partly the result of the wide range of economic policies, including commercial policy, credit policy, exchange-rate policy, and the like, which have encouraged capital-intensive techniques and industries, on the one hand, and discouraged investment in agriculture, on the other. The implications of these policies are the creation of a distorted price structure, where capital is underpriced and labour overpriced in the industrial sector. The policy of import substitution, affected by a high degree of effective protection has discouraged the export of manufactures and has encouraged diversification away from the products in which the region enjoys a comparative advantage in favour of manufactures.³⁵ The manufactured exports in which the ECAFE countries would have enjoyed a comparative

³⁵ An interesting paradox generated by this policy has frequently been the development of manufacturing industries dependent on a high import content, making the economy more import-dependent than it was prior to the import substitution policy's implementation.

advantage are the products of the labour-intensive industries. The discouragement of exports resulting from discriminator exchange-rate policies in many countries of the region have adversely affected the labour-intensive industries and hence the prospects of employment growth in the industrial sector. Naturally, the imposition by the developed countries of high import duties and restriction on imports of labour-intensive products from the developing countries has been a contributory factor in encouraging import substitution, and thus creating employment problems, in the developing countries.

There has been a lurking lack of confidence in the role of relative prices as an allocative mechanism in the developing countries, or as a means of shifting resources between alternative uses in a way which could orient the pattern of development in the direction suitable to get the most out of a country's factor endowment. It is increasingly realized, though more in countries outside the ECAFE region, that prices signals (which indicate relative scarcities or abundance of the different factors or outputs in domestic and international trade) are efficient allocators of resources, which may assist in combining growth of output with growth of employment.

Even if relative prices are restored to their function as resources allocators between alternative techniques and sectors, it is alleged that developing economies do not in fact have a choice between alternative techniques, faced as they are with the capital-intensive techniques of the developed countries. The extent or range of choice in the techniques of production has been a subject of some controversy. While the developing countries to a great extent rely on imported equipment incorporating the technology of the developed countries, there is no commodity that faces only one technique of production. Techniques vary between and within the developed countries in every line of production. Thus, there is a choice for developing countries, for instance between Japanese techniques and American or German techniques. Secondly, equipment of different vintages in the same country embody different technologies. The developing countries have a choice between the equipment "styles" of the 1920s and those of the 1950s or 1960s. It is argued, however, that the use of "outmoded styles" of equipment raises a number of problems: firstly, there is said to be the problem of regularity and adequacy of availability of spare parts; secondly, there is said to be no organized market for many kinds of "outmoded" equipment, so that there is no basis of comparison between alternative prices or qualities of equipment quoted by different suppliers. These difficulties, if they actually exist, are not insurmountable. In the first place, spare parts and components can be designed and produced in the user

country if it has a large enough market for them. Moreover, if an adequate number of developing countries buy and use "outmoded" machinery, an incentive will arise in the developed countries to supply spare parts or to sell blue prints and technical "know-how" to the developing country to take up their manufacture and world-wide supply. Furthermore, extensive use of "outmoded" machines by the developing countries will by itself help develop an organized market for them so that a basis of comparison and the necessary expertise for judging price and quality will develop in due course.

Pursuing this line of reasoning one step further, it can be argued that the appropriate policy for developing countries is to establish capital goods industries producing capital equipment of an "earlier" vintage. Equipment of earlier vintage will be more labour-intensive than more "modern" equipment. The trend in the developed countries has been towards more "modern" equipment—that is, equipment which uses relatively few labourers per unit of capital. Moreover, in advanced countries, it is no longer easy to purchase equipment of a vintage older than 1955 to 1960, whereas equipment of older vintage may be more suitable for the factor endowment of the poor countries. This is because earlier-vintage equipment is being rapidly relegated to the scrap heap in developed countries. As a result of the fast rate of technological progress in the advanced countries, equipment of any given vintage becomes rapidly outmoded in favour of equipment of a newer vintage, with a lower labour coefficient. This switching takes place even when existing factor prices would suggest that firms should choose equipment of older vintage. Under these circumstances, the optimum strategy for developing countries would appear to be the production in the developing countries of equipment of older vintage, copying aspects of the technology now outdated in the advanced countries. By producing the earlier-vintage Western equipment in their own industries, the developing countries would derive the benefit of controlling both the direction and speed of technical change in their own countries. The external milieu of technology would thus develop indigenously, along with the capacity to design and master it. The technological skill of the population can thus grow gradually, avoiding the jump which it would otherwise be required to make since the imported equipment is usually far out of line with the level of skill and technical education of the developing country. A capital-goods producing sector, in addition, can be a special source of skilled workers for the non-capital-goods producing sectors. Moreover, duplication of older-style equipment, which has been previously innovated in the advanced countries, obviates the need for a special corps of engineers to design new-style machinery. The advanced countries

will more readily part with their "outdated" blueprints than with those of their latest equipment, in which they compete with other machine producers in the rest of the advanced world.³⁶

From the point of view of labour absorption, the developing country has an additional advantage in producing capital goods of an earlier vintage since such production often constitutes one of the more labour-intensive branches of industry. Capital goods production for developing countries' markets is often not amenable to mass production methods because such production must be suited to specific orders embodying differing specifications. (It is true, however, that those branches of industry which supply inputs to the branch engaged in machine-building proper may be capital-intensive.) Moreover, small-scale operation is frequently efficient for such machine production, since there are often few economies of scale in view of its specialized, non-mass-production nature. There may, on the other hand, be scope for specialization by stages of production or by machine components. In course of time, domestic industry based primarily on copying the older-style equipment of the advanced countries, may develop its own capacity to design new machinery or adapt Western imported machinery to the requirements of its own factor endowment.

This brings one to perhaps the most important element of the choice of industrial technology, which the developing countries have only very inadequately exploited. As the historical experience of Japan and the recent experience of other countries, including the Republic of Korea, demonstrate, there is considerable scope for adaptation and what is called "innovational assimilation", innovating "on top of" imported technology in the direction of using relatively more of the abundant, unskilled labour force.³⁷ This kind of indigenous capital-stretching may be of three kinds: (a) relating to the machine proper; (b) relating to the production process as a whole, but emphasizing activities within the plant and peripheral to the machine; and (c) relating to the production process as a whole, though emphasizing plant size and differential processing arrangements at various stages.

With respect to the machine proper, the simplest, most important example of capital-stretching seems to be that which relates to the utilization of machinery in place, mainly by adjusting shifts and speeds of operation relative to institutional and other constraints

of the country in question. For example, triple shifting plus the speeding up of machines does not "wear them out" at nearly the same rate per unit of time-in-use, and, when accompanied by more attention to repair and maintenance, can be very important in cost terms. For instance, the average work-week per machine in the textile industry of Japan has historically amounted to at least twice or thrice that encountered in the United States, accounting in part for Japan's continuing competitive advantage. Sometimes, along with the higher speeds, cheaper raw materials can be used and compensated for by additional unskilled labour in handling the extra quality controls and repairs necessitated. As late as 1932, weekly man-hours per 1,000 homogeneous spindles ranged from 330 in Japan to 165 for the United Kingdom and 143 for the United States, suggesting the reliance of the first of these countries on labour as a cheap factor.

With respect to machine-peripheral operations, handling, transporting and packaging within the plant by humans instead of mechanical conveyor-belts can also be very important. Activities which may look inefficient and wasteful to the untrained eye often constitute highly efficient, sometimes machine-paced, capital-saving adaptations. For example, in the production of plywood in the Republic of Korea, what at first appears as a production process very similar to that carried out in the United States, turns out on inspection to be full of important variations on the basic theme. In the United States, machinery is used to detect defective pieces of lumber, and the entire side is then discarded. In Japan, defective pieces of lumber are located and cut out by hand. In the Republic of Korea, the defective area is located within the piece and patched up by hand. The same is true for marked international differences in the same electronics process, especially in assembly operations. For example, in Republic of Korea electronics subsidiaries, the same process, with wage rates ten times lower than their equivalent in the United States, shows 20 per cent greater utilization of the capital stock. Feeding and packaging on the assembly line are done by hand instead of automatically, and, with greater speed of operation due to faster operator pacing, additional labour is deployed in testing, inspection and repair.

The third type of capital-stretching innovation, that of the plant-saving variety, is often characterized by the coexistence of different historical stages of production in the same industry, or even in the same firm. For example, in textiles, spinning may be done at the large-scale factory level, with purchasing and marketing both enjoying economies of scale, while weaving is performed in the rural household, by courtesy of the puttin-out system. Even in the most

³⁶ Pack, Howard and Todaro, Michael, *Technological Transfer, Labour Absorption and Economic Development*, Yale University, Economic Growth Center Reprint, No. 143, 1970.

³⁷ Ranis, Gustav, "Industrial Sector Labour Absorption", Economic Growth Center Discussion Paper No. 116, July 1971.

modern industries subcontracts are common with respect to specific components and preparatory and finishing processes. Since plant amounts to close to 60 per cent of the total combined investment in plant and equipment in most of the developing countries, the development of labour-intensive machinery, e.g. looms, over a large number of scattered small plants can be substantially plant-saving while also harnessing substantial additional amounts of labour to satisfy the additional transport and handling requirements.

The services sector, industrialization and employment

An additional important source of non-agricultural employment is the services sector. Part of the expansion of the services sector is directly dependent on the expansion of industry, as, for example, banking, insurance, and wholesale and retail trade, as well as construction to a certain extent. Certain types of service activity become profitable only with the increase in population concentration which industrialization brings in its wake. "Market" size is a critically important consideration in the delivery of such services, as are education, especially higher education, medical and health services, transport, and public utilities. However, there are elements of expansion in the services sector which are directly related to the general increase in aggregate income rather than industrialization as such. Furthermore, expansion of employment in the services sector is related partly to the fact that productivity growth in the services sector is slower than in the other sectors. This is subject to the qualification that the measurement of productivity in the services sector compared with that in industry and agriculture raises a number of as yet unresolved conceptual and empirical questions.³⁸ It may be useful to conceive of the generation of employment in their sector as consisting of two parts, a "modern" (demand-determined) component and a "traditional" (supply-determined) component. As a rough approximation, all wage-earning and salaried employment in the services sector may be considered as "modern", whereas all non-wage or self-employment and unpaid family labour may be deemed "traditional". This division has distinct advantages. First, it helps to identify systems of employment under which the pattern of economic organization, the nature and structure of remuneration, and the level and types of skills are very different. Second, a distinction between wage-based and family-based self-supporting labour helps to isolate the existence of a special problem of low earnings in self-employment.³⁹ Third, it shows up the limitations of the popular

interpretation of Colin Clark's thesis that, at higher levels of income per head, a redistribution of labour takes place in favour of the services sector. The fact that the services sector's share of the labour force is quite large in countries with low income levels does not necessarily invalidate Clark's proposition, which applies mainly to the "modern", demand-induced types of service, related closely to industrialization.

The concept of income-elasticity of demand does not explain a large proportion of the self-supporting labour in "traditional" services, which inflates service's share in the total labour force. Only a small proportion of tertiary employment in the less developed labour-surplus economies seems to be a function of the high income elasticity of demand for services. The bulk is to be found in such traditional and "unorganized" services as shoe-shining and petty retail trades bearing no observable relationship to effective labour demand. Here the supply of labour creates its own employment opportunities by sharing out a given total amount of work. Even the expansion of employment in public administration and government services (sectors commonly regarded as typifying modern development) may reflect a social need to absorb labour which would otherwise be redundant. In conditions of excess labour supply, the most efficient utilization of some manpower resources may be considered less essential by governments than the inefficient utilization of all or most of them. Hence the overcrowding of government services when there is large-scale chronic unemployment, especially if such unemployment prevails among the better educated.

Urbanization and monetization of the traditional, subsistence sector normally bring in their wake a shift towards tertiary employment. There is some scattered evidence that a large part of the migrants out of this sector go into "service-type" occupations. The occupational distribution of migrants and non-migrants revealed by a recent survey sample in a metropolitan area of one east Asian country demonstrated that the largest shift of migrants was into sales and other service occupations (over 30 per cent) and not into the skilled or semi-skilled factory jobs.⁴⁰ Recent studies tend to show that in the Philippines there has been a discernible tendency for the services sector to absorb the large bulk of the annual increase in the labour force. It is in the composition and characteristics of the labour force absorbed into services that trends seem to differ among economies. It appears, that there has been a decline in unorganized services activities in the traditional sectors of some countries in the wake of rapid economic growth; in others, such as the Philippines, on the other hand,

³⁸ Bhalla, A. S., "The role of services in employment expansion", *International Labour Review*, vol. 101, No. 5, May 1970.

³⁹ *Ibid.*

⁴⁰ Bhalla, A. S., "The role of services in employment expansion", *International Labour Review*, vol. 101, No. 5, May 1970.

there has been a shift of traditional activities from agriculture to such areas as "unorganized" commerce. These two different phenomena suggest (a) that intersectoral labour flows in the less developed countries need not always be from agriculture to industry or to services by-passing industry, and (b) that labour transfers from one sector to another need not be from traditional to modern employments. In an economy such as the Philippines, where the rate of growth of industrial output has been relatively slow, surplus agricultural labour has shifted to traditional manufacturing and from there to traditional services when manufacturing expanded under conditions of modern technology. At higher rates of growth, however, as in the case of some other developing ECAFE countries, the potential labour surplus in traditional services has been absorbed into industry at the same time as the growth of industry has generated "modern" employment in complementary services; the net effect of these movements has been to raise the relative share of modern employment without necessarily raising the amount of labour absorption into services. The rate of transformation of traditional into modern types of labour thus depends on the rate at which the two processes take place in conjunction with industrial growth.

In planning for the future role of the services sector as a source of employment, it is important to recognize the heterogeneous character of the services sector, comprising activity ranging from sophisticated professional work to peddling and shoe-cleaning. In these subsections of the services sector, there are sizable employment opportunities for those with some years of schooling, who often experience high rates of unemployment. In recent years, wholly new opportunities for mechanizing and computerizing these areas have opened up on a large scale. If the computerizing of clerical and retail distribution services spreads from the rich to the poor countries, substantially fewer modern type service jobs are likely to become available. Increased employment in the services sector will take the form of precarious low-productivity self-employment in the traditional activity. The implication is that in the skilled services subsectors, as elsewhere, labour-intensive technologies should be stressed.

D. Agricultural development and employment

Agricultural employment and rural-urban migration

Whatever is done in the non-agricultural sectors, it is certain that the absolute number of people in the rural areas of the developing ECAFE countries is going to grow over the medium term. So the need for jobs in the agricultural sector will also continue to rise. The continued growth of the number

of people dependent on agriculture for their livelihood is the result of three factors: the initial large size of the agricultural sector, the high over-all rate of population growth, and the relatively small capacity of the non-farm sectors to expand employment. There is another reason for stressing agricultural employment opportunities. At the same time that developing countries are realizing the size of the employment problem they are learning that the agricultural sector is becoming less effective in retaining those who cannot find jobs in the cities. Under the pressures of improved communication and new aspirations, rural people are migrating to the cities much faster than the rate of increase in the number of industrial job opportunities.

The motives behind this migration are a complex mixture of urban "pull" (the attraction of higher wages, social, cultural and educational activities, and the glamour of the towns) and rural "push" (the desire to escape from conditions that offer only heavy, unrewarding jobs in an atmosphere of little hope). Such problems as mushrooming slums, the dangers of massive urban unemployment, and the drain of talented and ambitious people from the countryside can only be resolved with programmes that include a process of rural regeneration. Provision of urban jobs without measures to improve rural living standards and employment opportunities is likely to result, hand-in-hand in increased employment and unemployment in the town; every new job created in the city may attract two or more migrant families from the countryside.

Employment implications of the "green revolution"

Over the past few years, new dwarf wheat and rice varieties have spread to many parts of Asia. Their yields are at least double those of traditional varieties, and, if used wisely, they can raise the income of farmers very considerably as well as promote growth elsewhere in the economy. At the same time, the new cereal varieties require much more careful cultivation (better water control, more fertilizer, and more weeding) if they are to fulfil their promise. The combination of higher yields and improved cultivation means that more labour may be required for the new seeds and that the returns to that labour can be higher. Examination of the employment implications of the new agricultural technology raises a number of questions, including: Can the new agricultural technologies be used to provide more rural employment opportunities? How can developing countries design agrarian systems incorporating the new technologies to combine the goals of maximizing food output and productively employing the rural population? How can the developing countries best use the increases in cereal production to accelerate the

growth in output and employment in the rest of the economy?

The higher yields and the greater intensity of farming made possible by the new seed varieties should have a considerable effect in raising the amount of labour required per acre. At the same time, however, the efficiency of complementary inputs, particularly fertilizer and water, is improved by use of the new varieties. As a result, the required labour input for each unit of output is likely to decline. Thus, while yields may double, the increase in labour requirements per acre is not likely to increase by as large a proportion. This divergence is extremely important in any discussion of the over-all employment effects of the "green revolution".

While switching to the new varieties from traditional ones requires more labour, an even more significant increase in the demand for labour occurs as a farmer shifts from growing one crop a year to growing two or more (multiple cropping). Each crop requires that the land be prepared, the seed sown, the plants weeded and the grain harvested, threshed, stored, and shipped. The potential for multiple cropping is enhanced by the shorter maturation period of the new rice varieties. At the same time, the additional yields and profits from the new varieties make it worth-while for farmers to invest in water control facilities, which are essential for cultivation in the dry season.

In those areas where multiple cropping is made possible, the increase in employment seems to be roughly equivalent to the rise in the intensity of cropping. A study of some large farms in the Punjab (Pakistan) showed that, because of the longer working hours per man per day, and also because of the increased numbers of workers (both family labour and more especially hired hands), the input of labour per acre on farms irrigated by tubewells was on average 57 per cent higher than that on farms without irrigation. This corresponded closely to the increased cropping intensity due to the tubewells.

Although the introduction of the new cereal varieties by itself does increase the demand for labour, it is important to note that the variations both between and within regions are considerable, and that no areas in south or southeast Asia appear yet to have attained the degree of labour-intensity of farms in Japan and Taiwan.

Differential employment effects between large and small farms

In many respects the new varieties appear equally effective on any size of farm; that is to say, they

are neutral to scale. This seems to be true for the seeds themselves, for the fertilizer that is an essential component of their higher yields, and for other agricultural chemicals, all of which are divisible into very small units. But some other features of the new technologies offer returns to scale. Principal among these features are mechanization, irrigation, credit, and management. Each tractor size, for instance, is associated with a roughly fixed operating area, below which it quickly becomes uneconomical because of its undivisibility. Thus, large farms are in a position to make greater use of the advantages of mechanization. For irrigation, the most efficient units, e.g. private tubewells require a minimum command area, below which the costs of water per gallon and per acre rise sharply. The size of the minimum command area varies from 25 to 50 acres. Large farmers can sink a well of their own and use the water effectively; farmers who own less than the minimum command area have to depend on co-operation with others and on credit if they want to take full advantage of cheap water. However, the costs of credit are usually higher for small farmers than for large, both because the risks are greater and because the same amount of administration must support a smaller loan. This is aggravated in some areas by the reluctance of co-operatives and banks to lend to small farmers at all.

Agricultural economies of scale can bring a number of employment problems in their train. As the large farmers adopt the new seed varieties, they can reduce costs and increase output, generating additional profits for themselves. There have been tendencies in many parts of the region for the larger farmers to use these profits both to buy machinery that can displace labour and to purchase more land. Where small farmers do adopt the new varieties, it is reasonable to expect that there will be significantly greater employment of family labour and an increase in the demand for hired labour at peak periods of the year. Most small farmers are unlikely to mechanize their operations, so that the greatest possibilities of the high-yielding cereals in creating employment should be realized in these cases.

For those small farmers who are unable to make the transition to the new seed varieties, the prospects are bleak. They have to compete with a growing volume of cheap grain from the new varieties. Many of them will be unable to market economically what surplus they produce. These farmers are faced with three alternatives: they may retreat to a purely subsistence style of farming; they may take advantage of rising land values to sell out in order to clear their debts and to attempt a new start in life, most likely adding to the trek to the cities; or they can attempt to diversify into other agricultural product (which may be difficult since they lack the knowledge,

risk-bearing capacity, and institutional setting facilitating adoption of the new cereal varieties among other crops). The situation is particularly acute for those farmers whose farms are so small that they cannot provide even a subsistence livelihood for the cultivator and his family.

Agricultural mechanization and employment

The "green revolution" has been accompanied by a steep rise in the demand for mechanization of farm operations. The basic arguments advanced in favour of mechanization are:

(a) Power and equipment facilitate an increase in yields through more timely and effective farming. Optimum yields of the new seed varieties depend on correct seedbed preparation, proper seeding dates, precise fertilizer placement, and the uniform and timely distribution of water and chemicals. All of these operations can be better conducted through mechanization.

(b) The possibilities for multiple cropping put a premium on speedy harvesting and land preparation so that the next crop may be planted. This gives rise to peak season labour shortages when the demand for human labour exceeds the supply. Mechanization raises output by supplementing labour during the peak periods and so getting the next crop planted more quickly.

(c) Mechanization reduces the dependence on draught animals, which have low productivity and high costs. These animals also consume food sources of energy and so utilize land that would otherwise be available for growing food for human consumption.

(d) The fact that mechanization lowers the costs of production is important in terms of the overall growth of the economy because it permits the generation of savings for investment. It is also important for those countries hoping to lower costs in order to compete in the world cereals markets.

The following arguments are generally put forward in opposition to agricultural mechanization:

(a) The evidence of the effects of mechanization on yields and on farm costs is inconclusive.

(b) In countries where labour is plentiful, but both capital and land are in short supply, the most efficient mode of operation, in agriculture as in other sectors, is to utilize the abundant resource while conserving capital and land.

(c) In countries where capital is in short supply it should not be diverted into agriculture, where

labour-intensive alternatives are readily available and serve other valuable social and economic functions, which capital would destroy.

(d) Mechanization displaces labour. Since no other sector of the economy can readily absorb this labour, substantial social and economic dislocations will occur if agriculture is mechanized.

(e) Mechanization tends to accentuate the disparity in incomes between the large landowners and other farmers by enabling the former to lower their costs. The resultant competitive advantage for large farmers encourages the concentration of land and other resources.

The relationship between mechanization and crop yields is complex. It is evident that the productivity of the region's small farms can be raised without tractor mechanization, at least to a point considerably above their present levels, but some intermediate forms of mechanical advances are probably required in conjunction with the new cereal varieties. What these forms are in any particular situation is an important question and deserves a great deal of attention at the farm level.

There are two areas where selective mechanization is called for. The first relates to the need, in the case of multiple cropping, to accelerate certain critical operations through the use of machines; the second relates to the seasonal labour shortage for selected operations at peak seasons and the consequent need for mechanized procedures. The rise in wages observed in many countries at harvest-times can be taken as an indication (or even as an index) of labour shortage. It is important, however, to study the dynamics of the labour supply in the fields at these times. It is likely that higher wages attract more people, especially women and children, into the labour force; and, in response to seasonally higher wages, considerable migration of farm labourers has been noted in much of the region. More analysis needs to be done to discover the true extent of seasonal labour shortages and the extent to which multiple cropping is prevented by lack of labour. It is also essential to find out whether the families of landless agricultural labourers can earn enough income to survive throughout the year if they are denied higher wages during the peak seasons. In situations of real labour shortage (i.e. where production is held down because even a rise in wages does not call forth sufficient labour to handle the work) it will be necessary to devise appropriate mechanical methods to increase output without decreasing the number of jobs. Agriculture consists of an extensive series of farm operations. The time and energy required for some of these operations places distinct

limits on the reduction in time of the entire agricultural cycle. If special forms of mechanization can be selected for specific operations, blockages may be overcome, increasing both agricultural output and the over-all demand for labour.

The essential elements of the solution to this problem are to raise the interest rate and to value foreign exchange at a more appropriate, higher level with respect to capital. Where there is reluctance to do this, other special policies should be devised to control the rate and extent of agricultural mechanization because of the immediate, critical danger of rural labour displacement. At the very least, taxation and pricing policies should place the full burden of all costs on those farmers who purchase the machinery. Subsidies on agricultural machinery in the forms of undervalued foreign exchange, easy credit, and similar devices should cease. Another approach would be to place heavy taxes on agricultural machinery, preferably graduated by horsepower. An additional alternative is to increase the number of self-employed, viable small farmers at the expense of large landowners, in which case the mechanization problem might well be entirely avoided. In Japan, high yields on small farms have been obtained through the labour-intensive use of biological and chemical technology. The large farms, because of the problems of organization and management of large numbers of labourers, have continued to go in for mechanization. On smaller farms, labour is used much more intensively, and thus they have benefited from the new technology.

More needs to be known about the relationship between the new farm technologies and tenant insecurity. Where the new technologies and the increased accent on the commercialization of agriculture exacerbate tenant insecurity, counteraction is necessary. This would involve, at the outset, improving records of land occupancy and tenure conditions, registering tenancy, and enforcing existing regulations on rents and security of tenure. More ambitious programmes to give tenant-farmers a greater stake in rural development can then follow.

Effective land redistribution obviates the need for the mechanization of large farms. As the scale of farm units is reduced arguments about the difficulties of managing sizable numbers of labourers on single units would be eliminated. Then, too, if all farms are roughly the same size, services such as marketing, credit and irrigation can all be standardized to accommodate that size. In most Asian countries today, there are essentially two agricultural service systems, one for the large commercial farmers, and the other for small farmers and tenants—with resulting inefficiencies and inequities which would be

reduced if the variance in farm holdings were diminished.

Synchronizing agricultural supply and demand

It is extremely difficult to make predictions about the future world supply of wheat and rice, considering the vagaries of the weather and the uncertainties about the spread of the "green revolution". Although specific trends are not clear, the new technologies may allow the production of cereals in the region to grow at about 5 per cent a year; this seems to have been the average rate of growth over the past two years. If this continues, and if the rate of growth of supply continues to outrun that of demand, then prices will fall, which will be detrimental to small farmers and tenants struggling to enter the market economy. If the employment effects of the new seeds are to be maximized, it is essential to work to keep supply and demand rising in tandem and at a rapid rate.

There are basically three approaches that can be adopted to cope with this issue. The first of these is to try to increase directly the demand for cereals. Various methods, such as improved domestic distribution systems, promotional campaigns, and processing can contribute to this. Secondly, the increased efficiency of the new cereal varieties may allow the diversification of some agricultural resources into other types of production, such as feed grains, livestock, poultry, fruit and vegetables, dairy products, and fibres, for which the demand is growing in developing countries as urban population and incomes increase. And lastly, as some ECAFE countries reach the position of satisfying the internal demand for cereals, they may find prospects for exporting these or other agricultural products.

The need for diversification of the agriculture of the developing ECAFE countries is being hastened by the advent of new seed varieties. Fruit and vegetables, for example, use a great deal of labour and have a very high value of output per acre. At the same time, this type of produce requires careful processing, thereby creating further employment opportunities. The demand for fruit and vegetables in the region's developing countries starts from a low level but is growing rapidly. With support from the governments in the form of research, extension, credit, and marketing, this type of production may prove very useful for these countries. In the short run, dairy production may present the best opportunity for some countries to increase small farmers' employment and income. Dairy farming is an important agricultural commodity with a large existing production base. The demand for these products is very strong, and the necessary technology is often

suitable for small farmers. Finally, the demand for livestock and poultry, and consequently for feed grains, is increasing fast as incomes rise and the demand for high-quality protein grows. This will allow the developing countries to diversify into these areas, and thus to expand production and employment.

At present, however, the prospects are slim for most developing countries to achieve really significant food grain exports. For one thing, these countries have difficulty in meeting the quality standards demanded on the world market, and their internal prices are often considerably in excess of world prices (this is especially true of wheat). World food-grain markets are already facing excess supply, and thus declining prices. The prospects for exporting feed grains to supply the burgeoning livestock industries of the world are better, however. Thailand, for instance, has in recent years developed a very successful corn-exporting business. In 1969, it sold 1.5 million tons of corn abroad, primarily to Japan, Hong Kong, and Singapore. This amount exceeded the export tonnage of rice, for long almost the sole earner of foreign exchange. This trend may suggest possibilities for other developing countries.⁴¹

Linkages between agricultural and industrial employment

Besides the opportunities for employment expansion in agricultural production, the industries linked to agriculture will also be stimulated by the "green revolution." The production and marketing of new seeds, fertilizers, chemicals, and equipment will all create jobs. So will the processing and marketing of the increased grain harvest. And there will be further multiplier effects throughout the rest of the economy. It is possible, in fact, that the amount of employment created indirectly—to supply inputs to agriculture and to market the additional output from the high-yielding varieties—will exceed the direct employment effect of the "green revolution." In one of these linked industries, the manufacture of agricultural implements, the number of job opportunities created will be directly affected by the choice of agricultural technology. For example, if farmers demand complex machinery such as tractors, these generally will have to be manufactured in large, capital-intensive factories. But if they use less sophisticated equipment, such as tubewells, simple diesel engines, animal-powered ploughs, and seed drills, then these can be manufactured at the local level, in simple, labour-intensive factories. The field of marketing, in the broadest sense, will also provide new employment.

Very large investments in storage, feeder roads, processing and distribution will be required in order to maintain the momentum of the "green revolution" and to market the increased output—and all of these investments will, of course, create jobs. The central point is that if the twin problems of poverty and unemployment are to be alleviated, then the governments should adopt deliberate policies to create as many jobs as possible both directly in agriculture and in the linked industries. The "green revolution" creates opportunities in both areas.

An additional important effect of the introduction of high-yielding seed varieties is to make the supply of staple food grains more elastic, i.e. more able to respond rapidly to changes in demand. In the past, the fear of inflation generated by an inelastic food supply even under public programmes to raise agricultural production was responsible for dampening the desires of governments to engage in large programmes aimed at improving the rural employment situation. Since a very large proportion of wages is spent directly on food, and especially on staple food grains, an increase in governmental spending on labour-intensive projects tends to raise significantly the demand for food grains. Before the advent of the new varieties, this meant rising prices, since supply was unable to respond to the increase in demand.

The "green revolution" facilitates the successful execution of public works programmes, since demand generated by the latter for cereals can be readily met by their increased production. It is unlikely that public works programmes will provide a long-term solution to the employment problems of the developing countries, but as a medium-term palliative they form an important policy tool. Moreover, if the increased rural income that derives from additional cereal production is distributed fairly evenly, it should increase the demand for the kinds of simple consumer goods that can be produced domestically. These kinds of goods have the additional advantage that they can be made in relatively simple, labour-intensive factories, and the employment generated in such industries will also help to increase the demand for food. In sum, increased supply elasticity permits greater public initiative, and the resultant redistribution of income in favour of agricultural labour creates new markets for the expanded output.

A similar argument can be used to encourage the restructuring of industry towards medium- and small-scale industries. These provide simple consumer goods, such as textiles, utensils, and furniture, to satisfy the increased purchasing power of farmers producing the new cereals and of labourers employed in public works. Such industries tend to use local raw materials and to employ relatively large numbers

⁴¹ Shaw, R. D., *Jobs and Agricultural Developments*, Overseas Development Council, Washington D.C., 1970, p. 51.

of workers with relatively small amounts of capital. Like the labourers in public works programmes these workers spend much of their income on food. These medium- and small-scale industries cannot, however, grow without help. Their managers often lack the knowledge and capital to expand by themselves. Governments can encourage the expansion in this sector through a package of assistance, comprising research and design services, credit, joint training operations, and marketing.

Medium- and small-scale industries could form the nuclei of a network of rural growth centres, which would also help to raise the level of employment and the demand for food. This network would consist of series of small country towns strategically placed to supply goods and services to villages. They, in turn, would be linked to service centres and supply lines in large towns. The "green revolution" presents an ideal spur to such a strategy because the new agricultural technologies encourage the growth of the market economy and increase the demand for productive inputs, marketing facilities, and consumer goods. The growth centres could help meet these needs as well as provide social services quickly and cheaply for the farming community, thus raising its real income.

E. Some general development strategy conclusions

The incorporation of employment creation as one of the basic development objectives of the ECAFE region requires that development strategies be revised in a number of ways. Firstly, the policy of import substitution in the context of a distorted price structure of outputs and inputs has to be changed. Although there exists a unique and useful role for administered pricing in the early import substitution phase, this phase should be kept within bounds both in terms of the type of tools used and the time span over which it is permitted to dominate the scene. There are formidable obstacles in the way of a gradual termination of hot-house conditions once the *bona fide* objectives of such policies (i.e. infant industry protection and infrastructural construction) have been satisfied, partly emanating from the industrialists who have become accustomed to windfall profits and partly from civil servants who have become accustomed to power and to the additional incomes which grease the administrative wheels during this phase of development.

The basic elements of a more market-oriented pricing structure are fast becoming the conventional wisdom, i.e. a preference for tariffs over quotas; uniform tariffs over individually negotiated ones;

downward-trending tariffs over fixed tariffs; adjustable exchange rates over fixed pegs; import liberalization, permitting access to new and small importers and industrialists, over rigid licensing; and credit allocation through high interest rates rather than discretionary lending to established enterprises. On the wage front, it is clear that restraint is essential if the rural unemployed and underemployed, who are outside the industrially employed and unionized labour pool, and thus effectively disenfranchised, are to have any voice in the matter.

It is necessary to understand the factors which tend to increase the capital intensity of production in the developing countries. First, there is to some extent a mistaken preference for capital-intensive techniques and projects on grounds of prestige and visibilities. Second, advice on the choice of technology is even proffered by engineers from or trained in the advanced countries; high productivity to these engineers is synonymous with greater capital intensity in view of the factor endowment to which they are accustomed. Third, sales agencies from the developed countries aggressively promote their latest pieces of capital equipment, which are generally highly capital-intensive. Fourth, this problem is aggravated by the phenomenon of tied aid, under which aid (including export credits) is tied to purchases from the aid-giving countries. This rules out even the degree of flexibility of choice between the alternative techniques among the advanced countries. If aid is forthcoming from the United States, it has to be used to purchase United States capital equipment even in cases where comparable capital equipment from Japan or Italy may be more labour-using. The lack of trained supervisory and managerial personnel necessary for managing a labour force involved in labour-intensive techniques may, fifth, induce a choice of capital-intensive techniques. Sixth, there is a vicious circle involved in increasing capital intensity of production in developing countries since the fewer labour-intensive techniques employed, the smaller will be the opportunity to improve and develop a wider range of labour-intensive techniques. Techniques are improved and developed through use and research; if labour-intensive techniques are not used extensively, they will suffer from innovational stagnation and lose out to competition from capital-intensive techniques.

Future policy, in the developing countries as well as at the international level, must be directed towards removing the obstacles mentioned above, which discourage the use and development of labour-intensive techniques. There is a need for regional and interregional co-ordination of efforts and assistance for the development of technology appropriate to the labour-abundant countries. Similarly, greater

national expenditure as well as international assistance for manpower training to remove the shortage of organizational and managerial skill in working with labour-intensive technology is an important help in encouraging the use of labour-intensive techniques. The dearth of supervisors, technicians and key skilled workers, to mention only one problem, hampers the operation of additional shifts in the manufacturing industries — an obvious way of generating more employment. Skill shortages arise partly because the social returns from expenditure in training commonly exceed the private returns. Subsidies to entrepreneurs for encouraging expenditure on training could compensate for the fact that private employers who spend money on training their labour force may lose trained workers to competitors. Institutional training also needs to be increased.

A great part of the responsibility for the encouragement of capital-intensive techniques must be borne by the distortion of factor prices out of line with the factor endowment of the poor countries. Minimum wage legislation and other officially determined market imperfections, as well as pressures from trade unions, tend to put wages at a level higher than their opportunity costs. It is politically not feasible to reduce wages below the prevailing level. While wages as an element of cost are higher than the opportunity cost of labour it must, however, be remembered that wages are also sources of income, and it is not suggested that wages as a source of income are higher than they should be, given the needs of workers and their families. The problem of income distribution needs to be tackled as a separate and distinct issue, and in the context of all income classes. Raising the wages of organized industrial workers far above the level of rural wages or average rural income or above the level of wages in the unorganized urban sector does not necessarily improve income distribution in the wider sense, except for protecting the income of the privileged few. In so far as it discourages employment of labour, it aggravates the income distribution problem, since the unemployed earn zero income.

The use of social opportunity costs for the selection of techniques and projects in the public sector is relatively easy to enforce, though by no means simple. Once the public authorities have reached reasonable estimates of the social opportunity costs of labour and capital they can select projects and techniques on this basis. However, there will be financial problems in selecting projects and techniques on the basis of social costs while, in practice, paying market prices; the extra expenditure involved, if any, will have to be met by additional fiscal measures. For example, if labour-intensive techniques are employed because of the lower opportunity costs involv-

ed, but market wages are paid, the savings on capital may not be adequate to offset the rise in labour costs, since market prices of capital are kept artificially low in most developing countries.

At present a number of policies are followed, often to stimulate private investment, which encourage the capital intensity of production; they include (a) large and accelerated depreciation and investment allowances in calculating taxable income; (b) preferential licensing of capital-intensive investment; and (c) taxation of payrolls to finance supplementary benefits for workers and to provide funds for general revenue purposes and so on. Policies such as these need to be discontinued. Measures to encourage investment unwarrantedly cheapen the market cost of capital. The objective of reducing the capital intensity of production in the private sector can be promoted by such measures as (a) a reduction in the cost of labour through a wage subsidy or tax credit, together with an increase in the profits tax rate, or (b) an increase in the cost of equipment through an excise tax (or negative investment credit) together with a reduction in the profits tax rate. These measures can be expected to encourage labour intensity without discouraging capital formation.

A number of traditional labour-intensive industries, employing large numbers of people, are vulnerable to competition from large-scale industry using more capital-intensive techniques at implicitly subsidized market prices. The correction of factor-price distortion will help this sector; moreover, direct methods of assistance to this sector, which could prolong its survival, could have the same beneficial effects as the correction of factor price distortion through taxes and subsidies. Even if with a corrected price structure they cannot withstand competition, the large-scale displacement of labour consequent on their decline should be slowed down to match the rate of creation of employment opportunities elsewhere.

Moreover, there should be encouragement, including through temporary subsidies, of labour-intensive subcontracting, especially in the rural areas, in order to take maximum advantage of the local labour supply as well as dispersed entrepreneurial and saving capacity. More attention has to be directed to the "connectivity" of the agricultural and non-agricultural sectors in most of the developing countries of the region. Such "connectivity", both physical and institutional, is very much in evidence in all of the relatively few "success" cases; it is important not only from the point of view of minimizing output and employment conflicts by economizing on both private and social capital requirements; it also has very important incentive-related advantages with respect to agricultural productivity change.

In the agricultural sector it is necessary to avoid subsidies for tractors and other heavy equipment via low duties and/or low excises on domestic production (in addition to the impact of an overvalued exchange rate favouring their importation in the first place), threatening an uneconomic orgy of mechanization in the wake of the "green revolution". Moreover, land reform may well be necessary where large holdings prevent the intensive use of land through that application of more labour-intensive production processes.

One other obvious area for policy reform is in the international trade in labour-intensive industrial goods, as the developing countries move *en masse* towards export promotion. This means not only support for temporary preferences for exports from the

developing countries but, perhaps more importantly, the need for a sensible and thoroughgoing adjustment of assistance policy in the developed countries. If all the developing countries, however, began to take this policy advice, and accelerated their growth, exports, and employment on a broad front, rear-guard actions by the politically powerful, labour-intensive "sick" industries in the advanced countries could be expected to become more and more bitter. In fact, it can be argued with some conviction that, from the point of view of efficiency as well as political feasibility, it might be desirable to spend a part of the international aid programme in the domestic economies of the advanced countries in return for a lowering of quota and tariff barriers on the relevant commodities.

Chapter III

ECONOMIC GROWTH AND INCOME DISTRIBUTION

There has been a growing recognition in recent years that not only the absolute level, but the distribution, of a country's national income is important in determining the welfare of the people of that country and that greater equality in the distribution of income is necessary to satisfy the requirements of social justice. This recognition has created a need for more information on the existing national distributions of income, on the determinants of the distribution of income, and on the relationship between income distribution and economic development in the countries of the ECAFE region. Such information is necessary for the formulation and implementation of policies conducive not only to attaining the target of economic growth but also to improving the conditions of social justice. It is to this major task that the present chapter seeks to make a preliminary contribution.

In this preliminary study of the distribution of income in the countries of the ECAFE region, detailed references are confined to Ceylon, India, the Philippines and Thailand. Information on other countries of the region is entered into the study where appropriate, but limited availability leaves the coverage incomplete. It is hoped that all the ECAFE countries can be covered in greater detail in subsequent studies as data and improved analytical techniques become available. In any event, there is sufficient diversity in the development patterns of the countries covered in detail in this study to justify a number of tentative, but meaningful, conclusions.

This chapter is divided into four major sections. In the first, various issues related to the statistics, methods, and concepts employed in the analysis of income distribution are reviewed. The second section recounts the individual data with respect to Ceylon, India, the Philippines and Thailand, and ends with a brief discussion of international comparisons. Some general aspects of income distribution in the ECAFE region are covered in the third section, with particular attention given to the connexion between income distribution, on the one hand, and social justice and growth, on the other. The chapter ends with a section which draws some general conclusions.

A. Conceptual, methodological, and statistical issues

Income distribution can be studied by industry of origin as well as by factor shares. The classical

method of studying the distribution of national income by factors of production (land, labour and capital) was perhaps suitable for the distribution of income that prevailed prior to this century, but this approach has become largely outmoded as the concept of capital, in particular, has become more complex and as its ownership has become more diversified among the population.

This study accordingly relates to the distribution of income by size. The incomes of persons from work (as well as from property and transfers) in any sector are industrial sub-groups, and an analysis is made of the degree and composition of income inequality and of the demographic and economic factors which influence its distribution. This treatment is applied to both personal income (income before direct taxes) and disposable income (income after tax). Each of these matters will be discussed to the extent to which available data permit.

Nature of statistical information

The size distribution of personal income is, in effect, a frequency distribution, showing personal income units ranked according to their income size. The form of such a distribution varies, depending on the concept of personal income adopted, the definition of income-expenditure unit used, and the length of time over which the income flow is measured. In addition to these objective differences, there are differences attributable to statistical error. The magnitude of the statistical error in each case depends on the way in which the actual size distribution of the population is estimated from potentially biased information acquired from a population sample. Error can thus creep into both the population and income variables employed.

In addition to these matters there is the purely informational problem, which, even in developed countries with advanced systems of data collection, assumes serious proportions. Information about income can be obtained from various types of sources, some of which are given below.

If the coverage of a *population census* is fairly complete and income answers reliable, it will probably be the best available source of information concerning income distribution. In developing countries (and to some extent also in developed countries) coverage is usually only partially complete, and those

population elements not covered will often be among the poorest of the population. In addition, developing countries are rarely able to include questions on income in their population censuses simply because of the non-response, administrative and clerical problems involved.

Another income data source is *income tax returns or assessments*. However, these data usually suffer from a multitude of deficiencies. The lowest income brackets are usually not liable to income taxation, and thus no information will be available about their incomes. Also the income concepts used are those applied for purposes of studying the social problem of income distribution; for instance, capital gains may be excluded. Comparability may be reduced because some developing countries do not have unified income tax schemes. Finally, there is the problem of tax evasion, which even in developed countries often assumes serious proportions. It stands to reason that evasion is more serious in the case of profits and interest than for wages and salaries, and it is thus more serious among the upper than the lower income brackets. There is little doubt that tax evasion is a much more serious problem in developing than in developed countries. Indeed, only rarely are income tax data in developing countries of such a quality that they can be used for studying income distribution in a meaningful way.

Special *household surveys* may also give information about household income. Such surveys have been made in several developing countries and form the basic statistical material used in this chapter. Provided that scientific sampling methods have been used and adequate questions have been asked, this source of data should, in principle, be superior to all others because it can be designed for the special purpose of studying income distribution. In practice, however, the sample may be biased, and answers may be incorrect. Generally, the less developed a country, the less reliable will its survey data tend to be, and quality may vary greatly from sample to sample.

A common deficiency in these three sources of data is that information about the tails of the income distribution is unreliable, if not entirely missing; the very poor are simply not picked up, and the very rich purposely fail to respond. This is most noticeable in the case of income tax returns and household surveys, particularly those for less developed countries. The implication is that income inequality tends to be underestimated, and more so in the less developed countries; comparisons between countries should take this bias into account. It follows also that comparisons over time should be made with great caution.

The distribution of personal wealth is even more difficult to study. Population censuses usually do not collect information on people's net worth. Few countries tax net worth, and, in those that do, evaluation adds an additional serious problem to all the others related to tax returns. In rural areas in less developed countries, in particular, distribution of land may be used as an indicator of distribution of both wealth and income. This indicator should, however, be used with caution. Land registration may be decentralized (in which case big owners may appear as several smaller owners); fertility, state of cultivation and, hence, value and income of land differ greatly between regions and districts and even between holdings; holding (cultivation) and ownership do not always coincide because of land tenancy institutions; and so forth. Nevertheless, for comparisons over time within a country, land distribution may give valuable information because many of the above-mentioned factors remain relatively constant over time. Agricultural censuses, finally, may give information on both assets and debts for individual farms; but these are available for relatively few developing countries. The difficulties encountered by any study of income and wealth distribution in developing countries are thus enormous.

Concept of income

The final use of income distribution statistics determines their form and scope. Income is a flow concept and can be quantified alternatively as the sum of receipts to factors of production or as the disbursements for goods and services produced. The distribution of personal income can itself be measured either as personal income payments for factor services rendered or as personal income receipts placed at the disposal of family units. While it is somewhat easier to obtain data on factor income accruing to labour, there are usually no reliable and detailed data obtainable in respect of non-labour factor income to persons.

Furthermore, the problems involved in making correct estimates of non-money income, which constitutes an important component of national income, particularly in the less developed countries, are well known. Because of the predominance of agricultural output in total output in these countries, annual income is subject to wide fluctuations. The year chosen for the purpose of studying income distribution may thus over-state or under-state the degree of long-term inequality. Similarly, regional and urban rural differences in price levels, which are likely to be more pronounced in developing countries where unified markets for goods and services are a rarity, may influence purchasing power, and consequently the welfare component reflected in a given amount of money income.

Personal income and disposable income are considered more appropriate concepts than factor income for the purpose of measuring welfare. The distribution of disposable income or personal income implies the distribution of economic resources at the disposal of the income and consumer-welfare units for their consumption and saving. The Keynesian contention that the distribution of personal income influences the fraction of national income earmarked for private consumption and saving presupposes a comprehensive income concept which includes not only factor income but also net transfer payments receipts. In practice, however, it is not easy to estimate personal income in this comprehensive sense, largely because transfer income, usually small in developing countries, is not susceptible to realistic measurement.

Unit of study

Ideally, the recipient unit for the purpose of studying personal income distribution should be the "individual" because it is individuals who participate directly in the productive process. In practice, however, the individual unit yields a less than adequate understanding of the socially relevant distribution of income, which is best studied by reference to the "family". The definition of a "family" is unlikely to be the same everywhere, and the number of income earners in a family will vary. Most authorities hold that the distribution of disposable income by family or consumer welfare unit is much less susceptible to analysis than the distribution of factor earnings by individuals. The combination of individuals into a family or consumer unit has no connexion with the productive process, even though the economic environment may markedly influence the pattern of family formation and development.

Secular income

In view of the inevitable income fluctuations the level of income in a single year may give no idea of the long-run level of living. Hence, it is contended the secular structure of income—the size of the stock of durables, the amount of free government services available, etc.—should be taken into consideration for the purpose of long-run income distribution.

Measurement of welfare

There is a consensus of opinion that money income is a grossly inadequate measure of welfare.

The level of welfare reflects the adequacy with which economic means satisfy specified wants. One type of variation in annual incomes is that which causes personal dissaving when current consumption levels are maintained during transitory income shortfalls. It is contended that a longer measurement period over which incomes might be averaged would reduce the bias in income distribution arising out of annual income variations. By extending this logic to its national limit, life-time average annual income would be considered a superior measure of economic means.

Adequate information about sex, age, years of schooling and material wealth may yield an individual's life-time income profile. Age, in conjunction with the wealth position of an individual, measured in terms of his material net worth and the human capital invested in his education and training, may give a rough idea of his expected life-time income. The inequality of income distribution in a society is then most meaningfully summarized by the size distribution of such reconstructed life-time income profiles or average annual incomes. Research on the welfare implications of income distributions should consequently be directed chiefly towards developing a full understanding of the interactions of personal income, wealth and age.

However, no precise distribution of life-time incomes and welfare can be constructed in the absence of adequate data on personal wealth, and no such data are available. Consumption, which is probably more closely correlated to average life-time income than is current annual income, may be a better measure of welfare.¹

Measures of inequality

The problems of formulating a mathematical expression to describe a frequency distribution and of finding a measure of inequality applicable to the size distribution of incomes have been tackled by many authorities. Those of the statistical theory school have proposed general laws to describe size distributions of consumption, income and wealth. Others have confined themselves to devising analytical or graphical methods for measuring inequality without committing themselves to any particular theory of distribution.

¹ On the same assumptions, the size distribution of household consumption is a far better approximation of the size distribution of what Friedman calls "permanent income" than the size distribution of measured annual income. See Friedman, M., *A Theory of the Consumption Function*, National Bureau of Economic Research, Princeton University Press, 1957, pp. 209-210.

Methods suitable for analysing available data on size distribution of income in developing countries are still lacking. The most popular measures, namely the Lorenz Curve and the Gini coefficients, have been used in this study, together with decile shares, to enable comparisons to be made and tentative general conclusions drawn. The recognized limitations of these measures with respect to income inequality must, however, be borne in mind.

The interpretation of the inequality shown by a given distribution is, of course, dependent on the underlying definitions of income, recipient unit and income period. In view of the various limitations affecting available data and variations in the measures of income inequality, size distributions have always been a somewhat synthetic affair. "Unlike the information on industrial structure, the evidence on the distribution of income by size is more in the nature of synthetic estimates".² The current emphasis is therefore not so much on measurement of the degree of inequality as on the underlying forces which are mirrored in changes in income-size distributions. "The essence of the matter is not inequality, but what it stands for".³

Inter-country comparisons

Caution is required in making inter-country comparisons. Generally speaking, statistics on the distribution of personal income are scarce and not particularly suitable for analysing either the determinants of the functional distribution of factor income by persons or the welfare consequences of the distribution of disposable income by families. Data collected in family budget or consumer surveys are likewise unsuitable for such purposes and are not comparable *inter se*. For a variety of reasons, consumer expenditure or income, particularly for the highest and lowest income categories, tends to be under-reported or not adequately covered in the samples, and these biases are not uniform among countries.

Accordingly, thorough inter-country comparisons demand intricate adjustments for the methodological differences in the national statistics concerned. There is, in any event, no consensus on the scope or func-

tion of international income distribution statistics.⁴ Allowance must also be made for the wide differences in countries' economic and social institutions in deducing the welfare implications of personal income statistics in a particular national environment.

B. Distribution of income: selected countries

There are wide variations in the size, population, level of *per capita* income and economic structure of the countries in the ECAFE region. Asia contains slightly more than half of the world's population. Statistically, average *per capita* income for the whole of Asia was about US\$160 in 1965. When Japan (which has some 6 per cent of the region's population and accounts for nearly one third of total regional production) is excluded, average *per capita* income for the remaining countries was about US\$100 in 1965, being US\$133 in Ceylon, US\$89 in India, US\$218 in the Philippines and US\$106 in Thailand.⁵ But what about the distribution of income around these simple averages? Detailed data on income distribution are available for Ceylon, India, the Philippines and Thailand, and will be discussed below.

Ceylon

(a) Source of data

Data on income distribution are available from surveys primarily concerned with other types of economic information and from the Census reports.

⁴ For a methodological review of existing international statistics on income distribution, see United Nations, *Statistics of the Distribution of Personal Income*, document E/CN.3/L.42 of the Statistical Commission, 17 September 1957; and *Economic Survey of Europe in 1956* (United Nations publication, Sales No.: 1957.II.E.1), Chapter IX: Economic Commission for Europe. Also useful are United Nations, *National Income and Its Distribution in Underdeveloped Countries*, Statistical Papers, Series E, No. 3, (United Nations publication, Sales No.: 51.XVII.3), and ECAFE, "Analysis of National Income in Selected Asian Countries", *Economic Bulletin for Asia and the Far East*, January-June 1952, vol. III, Nos. 1-2, pp. 13-26.

For analytical studies of various sets of international data on income distribution, see Kuznets, Simon, "Quantitative Aspects of Economic Growth of Nations, VIII: Distribution of Income by Size", *op. cit.* Kuznets concentrates on the size distribution of income by family unit. He pools and refines a wide array of data from many countries at all stages in their economic development and from many different periods in a particular country's development.

On the other hand, the *Economic Survey of Europe in 1956* employs only income tax data for five rather similar European countries in the immediate pre-war and post-war years. The United Nations investigation focused on what is called the factor distribution of income among income recipients, and studied each body of data (where possible) by income type, economic sector of origin, social status of recipient, and age of recipient. Even among these rather homogeneous European countries, the data failed to support uniformly any new conclusions.

All these studies are useful as they compare and contrast international data, and draw cautious conclusions and generalizations from the data they examine. They also illustrate how dangerous it would be to draw any definite conclusions from such data.

⁵ Yearbook of National Accounts Statistics, 1969 (United Nations publication, Sales No.: E.71.XVII.3), Vol. II.

² Kuznets, Simon, "Quantitative Aspects of the Economic Growth of Nations, VIII: Distribution of Income by Size", *Economic Development and Cultural Change*, January 1963, Part 2, pp. 1-80.

³ Kuznets, Simon, "Economic Growth and Income Inequality", *American Economic Review*, March 1955, pp. 1-28.

The primary emphasis in these surveys has not been on the study of income distribution, and the information gathered is accordingly not sufficiently comprehensive to permit thorough analysis. The income tax statistics are of very limited usefulness because of the relatively small number of income tax payers, only 0.9 per cent of the total population in 1968-1969.

The size distribution of income is based on the 1953 and 1963 surveys of consumers' finance in Ceylon and on the socio-economic survey conducted in 1969-1970 by the Department of Census and Statistics, which involved 12,000 households. The survey of rural credit and indebtedness carried out by the Central Bank of Ceylon in October/December 1969 will provide useful information for future studies.

(b) *Distribution of income, 1953 and 1963*

The consumer finance survey of 1953 showed that most income recipients are clustered around the lower income brackets; the top 1 per cent of income recipients accounted for 18.2 per cent of total income and the bottom 10 per cent for 1.4 per cent. The concentration ratio (by "spending unit") worked out at 0.46 for 1953.

Average monthly income in Ceylon in 1953 was Rs 107.4. For the estate (landed estates) sector, the average was below that for the country as a whole, being Rs 58.50, and for the non-estate sector it was Rs 121.80. The lower income of the estate sector is attributable to the fact that income recipients are predominantly unskilled labourers whereas the non-estate sector covers many occupations in which people are well paid or self-employed.

The 1963 Survey showed that about 79.65 per cent of income-earners received under Rs 350 a month, 52.66 per cent under Rs 175 and 27.20 per cent under Rs 100 per month; only 14.20 per cent of the total population earned more than Rs 400. The bulk of recipients (74.42 per cent) were in the under-Rs 300 group.

(c) *Changes in income distribution*

Average income per recipient was Rs 267.39 for two months in 1963, as against the 1953 figure of Rs 214.80. This was therefore an increase of 25 per cent in average income (an annual increase of almost 2 per cent) for the ten-year period. After adjustment for the price increase of 10 per cent (as measured by the Colombo consumers' cost of living index), the ten-year rise in real incomes amounts to 13 per cent.

Median income rose by 25 per cent (Rs 132.6 to Rs 165.6) for the same period. In 1953, only 0.29 per cent of income recipients had a total income for two months of over Rs 2,000, and this group received 12.28 per cent of all income. In 1963 the percentage of income recipients in this group increased to 0.36 per cent, but their share of all income fell to 7.19 per cent.

There was a decline from 70.25 per cent in 1953 to 59.16 per cent in 1963 in the share of income recipients under Rs 200 (for two months). The proportion of income recipients in the group Rs 200-300 rose from 27.63 per cent in 1953 to 36.51 per cent in 1963. This upward shift in the frequency of high incomes prevailed in all income groups above Rs 200.

According to the Surveys the proportion of all income accruing to the top 1 per cent declined from 18.2 per cent in 1953 to 12.43 per cent in 1963. The fact that there was also a reduction in the proportion of income received by the lower income brackets was not due to a decline in the average incomes of the lowest income groups, but to the movement of a large number of their members into higher income brackets. The share of total income received by the lower income groups had therefore fallen.

Table I-3-1 shows the distribution of income (by income groups of households, and with individuals as income recipient units). The income received by the highest (decile) income group (individual as recipient unit) declined from 42.49 per cent in 1953 to 39.24 per cent in 1963, while that of the next decile increased from 14.16 per cent in 1953 to 16.01 per cent in 1963. There were slight increases in the share of income received by the remaining tenths;

Table I-3-1. CEYLON: DISTRIBUTION OF INCOME
(BY INCOME GROUPS OF HOUSEHOLDS)
(in percentages)

Income group	Personal income ^a			
	1953 ^b	1963 ^b	1953 ^c	1963 ^c
1st decile . . .	1.5	1.2	1.9	1.5
2nd decile . . .	3.5	2.7	3.3	3.0
3rd decile . . .	3.6	3.6	4.1	4.0
4th decile . . .	4.4	4.5	5.2	5.2
5th decile . . .	5.7	5.5	6.4	6.3
6th decile . . .	6.3	6.8	6.9	7.5
7th decile . . .	7.9	9.0	8.3	9.0
8th decile . . .	10.4	11.5	10.1	11.2
9th decile . . .	14.2	16.0	13.2	15.5
10th decile . . .	42.5	39.2	40.6	36.8
Total . . .	100.0	100.0	100.0	100.0

Source: ECAFE study.

^a Figures have been rounded to the nearest decimal point.

^b Individual as income recipient unit.

^c Household as income recipient unit.

except in the three lowest brackets: in the eighth-tenth, there was no change, in the ninth, income decreased from 3.56 to 2.70 per cent, and in the lowest bracket from 1.51 to 1.17 per cent.

According to the data for 1969-1970, 45.6 per cent of the spending units were in the lowest income brackets (Rs 50-199) and received 21.5 per cent of total income, whereas, in 1963, 71 per cent received 38.3 per cent of total income. This indicates that there has been a marked reduction in the number of spending units in the lowest income brackets and a movement into the next two higher groups.

As for distribution of income in relation to spending units, in 1963 71 per cent of the spending units received less than Rs 200 and had 38.3 per cent of total income, whereas, in 1969-1970 45.6 per cent had 21.5 per cent of income. In 1963, 19.7 per cent of the spending units were in the income group Rs 200-399 and 26.9 per cent of the income, whereas, in 1969-1970, 35.2 per cent of the spending units in that group received 34 per cent of total income. In the income bracket Rs 400-599, the number of spending units increased from 5.6 per cent in 1963 to 11.2 per cent in 1969-1970, while income received rose from 13.4 per cent to 18.6 per cent.

The analysis in terms of spending units and income receivers shows that income disparities have greatly decreased over the years and that the trend towards greater income equality which was evident in 1963 has gathered momentum.

The concentration ratios were 0.45 in 1953 and 0.41 in 1969/70. However, since the data of all these surveys are not strictly comparable and relate, in any event, to terminal years, the ratios should be interpreted cautiously as indicative of trend, rather than as representing the exact magnitude of inequality.

(d) *Rural-urban differentials*

Rural-urban distribution data are available for 1953 and 1963. In 1963, income recipients in the urban sector accounted for 28.2 per cent of total income, and the rural and estate sectors for 63.2 per cent and 5.9 per cent, respectively, of the total. The percentages of income recipients in the urban, rural and estate sectors were 14.9, 65.5 and 19.6, respectively. Accordingly, the estate sector experienced the least inequality while the urban sector had the largest measure of inequality. Income recipients in the second twentieth group received, on average, their corresponding share of income. In all the zones and sectors, except the estate sector, the lowest twentieth

of the income recipients had one half or less of the share of the next highest twentieth group. The degree of inequality of incomes in the urban sector is as high as that for the country as a whole.

(e) *Planning efforts and income distribution*

The ten-year plan issued in 1959 was the first attempt at a comprehensive plan for both the public and private sectors. The problem of unemployment was one of the key planning questions in Ceylon, and emphasis was therefore placed on fields of productive activity for the future work force, which was expected to more than double in the 25-year period ending in 1981. The basic objectives of the ten-year plan were to raise the standard of living gradually and to bring about a reduction in unemployment and underemployment. This object had not been emphasized in the previous plan, prepared in 1955; like that plan, however, the ten-year plan failed to get off the ground. When it was found that the ten-year plan could not be effectively implemented, a short-term implementation programme was presented in 1962. Since 1964 no comprehensive plan has been in operation; the emergence of state enterprises has, however, continued to have a redistributive impact by reducing the economic power of the entrepreneurial class.

(f) *Other efforts to alter income distribution*

Data on distribution of income after tax are not available. However, such taxes as wealth tax, gift tax, estate duty and a capital levy (imposed in 1970-1971) have a redistributive effect; their impact, however, is necessarily felt only in the long run.

Under the recently introduced peasant colonization scheme, colonists are provided with temporary camps constructed by the Land Development Department. They are given a grant of Rs 80 by the Land Commission for the construction of temporary huts for family occupancy and a subsidy of Rs 1,000 by the Land Development Department for the construction of a certain type of cottage. Land allotments are distributed in lots of 30 acres per 15 colonists and have to be cleared in time for chena cultivation in the Maha season of the same year. The colonists are paid a subsidy of Rs 100 per acre for jungle clearing. The cost of each of the temporary buildings, which are erected at the rate of one building per unit of 40 colonists, is Rs 2,350. A further subsidy of Rs 100 is given for the clearing of forested high land. Civic amenities, schools, dispensaries, co-operative societies, post offices and community centres are provided for the colonists.

(g) Movement in wages

In all sectors, money and real wages have risen to some extent. After the devaluation of the rupee in November 1967, there was a general upward revision of wage rates for employees in government service. Indeed, employees in government service have consistently received better scales of pay, fringe benefits and superannuation benefits than employees in the private sector; most people who seek work want to become government employees for this reason. In 1970 there were 303,674 government employees; since they already belong to the better-paid category of workers, any increase in their wage rates amounts to a further extension of their income position beyond the economy as a whole; this tends to widen salary-wage differentials within the salary-wage group in the economy. The growing preference for government jobs amid rising unemployment is also indicative of an inadequate alignment of educational planning with planning for job opportunities.

(h) Subsidies and social service expenditure as income redistributors

The social services provided by the State since the end of the Second World War have also had a very significant redistributive effect on income and wealth. In this respect, subsidies on basic foodstuffs, free education and free health services are important. The subsidization of foodstuffs, mainly rice, was a legacy from the war-time rationing and price control of essential goods. Rice rationing and the fixing of rice prices were introduced in February 1942, since then there has been a subsidy on rice. From December 1966 onwards, the Government has increased the subsidy by giving one measure of rice free of charge. The subsidy on rice for a family of six adults today amounts to Rs 6 per week or Rs 24 per month. This subsidy is now enjoyed by all categories of persons, including those paying income tax.

In addition to education, medical and other welfare services, the prices of various other essential public services have also remained remarkably stable over the last two decades. No systematic assessment of the impact of public expenditure on the improvement of skill and on the consequent effects on earnings has been made. There is yet no indication of any movement towards equalization of access to educational and training facilities.

(i) Land distribution

In rural areas, paddy lands are the most important form of wealth. Data show that about 33 per cent of all paddy lands are cultivated by non-land owning tenant farmers, which implies that the cultivators of the bulk of the country's paddy lands own

their own land, although the size of their plots is very small: the average holding being only about half an acre. There are, however, a number of landowners in the eastern and southern provinces who own large tracts of paddy land.

India

Systematic studies have been made of the distribution of personal income in India for the years 1953/54 to 1956/57⁶. These studies present data on income distribution by size of income and by functional categories. Income distribution by size for rural and urban areas is also given, as are data on pre-tax and post-tax distribution of personal income as well as disposable personal income. In what follows, the "household" is the income-receiving unit considered, except where otherwise stated.

(a) Distribution of income 1953/54 to 1956/57

These studies revealed that, during the period covered, the top 5 per cent of households received 20 per cent of total personal income (17 per cent of rural income and 26 per cent of urban income) and 19 per cent of disposable income (17 per cent in the rural sector and 24 per cent in the urban sector). The top 10 per cent of households received 25 per cent of rural personal income and 37 per cent of urban personal income, their shares in disposable income being 25 per cent and 36 per cent, respectively. The concentration ratio worked out at, respectively, 0.31 and 0.34 for rural and urban personal income, and 0.306 and 0.382 for rural and urban disposable income. The over-all concentration ratios were 0.34 for personal income and 0.335 for disposable income.

(b) Rural-urban differentials

Income distribution in the rural sector was more equal than in the urban sector. Of the total number of households, 79 per cent were rural and 21 per cent urban; rural households received 71 per cent of total personal income, while the urban households' share was 29 per cent. In the urban sector, the "high-income" urban households (those having annual incomes of Rs 3,001 and over, i.e., US\$401 and over) formed 11 per cent of all urban households and had 39 per cent of total urban personal income. In the rural sector, on the other hand, only 3 per cent of the total rural households were in the "high-income" group, having 12 per cent of the total personal income of the sector.

⁶ Ojha, P. D., and Bhatt, V. V., "Distribution of income in the Indian economy 1953/54 to 1956/57", *Reserve Bank of India Bulletin*, September 1962, and "Pattern of income distribution in India: 1953/54 to 1956/57", *Reserve Bank of India Bulletin*, September 1963.

The average income per household of "high-income" families in the rural sector was Rs 4,564 (US\$608); in the urban sector it was Rs 5,985 (US\$798). For low-income households, the average income was Rs 1,044 (US\$139) in the rural sector and Rs 1,212 (US\$162) in the urban sector. When farm and non-farm categories are compared, 3 per cent of households in the farm sector were in the "high-income" groups, receiving 12 per cent of the personal income of the farm sector; households in the "high-income" bracket in the non-farm sector formed 8 per cent of all households in the sector, claiming 26 per cent of the total personal income of the sector.

(c) *Salary — non-salary distribution*

Of the total number of households, 4.7 per cent were in the "high-income" group; of these, 52 per cent were non-salary-earner households, 42 per cent farm households and 6 per cent salary-earner households. The personal income of the non-salary-earner groups, the salary-earner group and the farm household group constituted 61 per cent, 11 per cent and 28 per cent, respectively, of the total personal income of the "high-income" group. The households and income of the "high-income" non-salary-earner group constituted 2.4 per cent and 11.9 per cent, respectively, of the total number of households and the total personal income.

(d) *Change in income distribution*

Analysis of the change in income distribution in the interval between the two periods covered in the studies (i.e., 1953/54-1954/55 and 1955/56-1956/57) had indicated that a tendency existed for the inequality of income in the urban sector to increase. Hence, it was expected that the income distribution pattern in India might become more unequal as development proceeded; the rise in the concentration ratio in the urban sector was indicative of this trend.⁷

In order to ascertain the change in this pattern during a decade or so, a similar study is in progress, and tentative estimates of size distribution for the periods 1953-1955 and 1961-1964 have been completed. The estimation procedures and methodology are broadly the same as those adopted for the earlier studies. However, the following modification is made for the new study.

In the earlier studies, the "household" was taken as an income recipient unit. For this purpose *per capita* expenditure brackets as given by the National Sample Survey (N.S.S.) were converted into per household expenditure brackets. This procedure, it is believed, may not have been analytically sound, as household size differs in different expenditure brackets, although the error involved is unlikely to be large. However, for the sake of accuracy, since the N.S.S. data are given in the form of *per capita* expenditure brackets, the "individual" is taken as the income recipient unit for the new study of income distribution.

Estimates are made for two periods; period I covers the years 1953/54 and 1954/55, and period II the years 1961/62 and 1963/64. The N.S.S. data are available in published form only up to 1963/64, and there are no data for 1962/63. Since year-to-year fluctuations in the N.S.S. data do not seem plausible, years have been grouped in such a way as to give a reliable picture.

The trends in income distribution are broadly the same as those indicated in the earlier studies. They are:⁸

- (i) The urban pattern is more unequal than the rural pattern; the concentration ratio for the two periods was 0.343 and 0.319 for the rural sector as against 0.401 and 0.474 in the urban sector;
- (ii) There has been a reduction in income inequality in the rural area in period II, compared with period I, while urban inequality seems to have increased;
- (iii) As a result, the over-all income distribution was more unequal in period II than in period I; the concentration ratio for personal income increased slightly from 0.376 to 0.385. The pattern of change with regard to disposable income was similar;
- (iv) The share of the top decile in personal income rose from 35 per cent in period I to 40 per cent in period II; however, its share in disposable income rose from 34 per cent to over 35 per cent, which probably demonstrates the effectiveness of tax measures in reducing inequality to some extent;

⁷ Ojha, P. D., and Bhatt, V. V., "Pattern of income distribution in an underdeveloped economy: A case study of India", *American Economic Review*, September 1964, and their "Reply to comments", *American Economic Review*, December 1965.

⁸ Ojha, P. D., and Bhatt, V. V., "Pattern of income distribution in India: 1953-1955 to 1961-1964", paper presented at the Seminar on Income Distribution organized by the Indian Statistical Institute, New Delhi, February 1971.

- (v) The share of the bottom 10 per cent in personal income declined in period II, compared with period I, but its share in disposable income and consumption remained the same in both periods.

(e) *Other studies*

Using the same methodology and data sources adopted in these earlier studies, with certain adjustments, the ECAFE secretariat in 1971 made another estimate of the pattern of income distribution in the Indian economy. The study covers the years 1953/54, 1956/57, 1957/58 and 1961/62; for 1953/54 and 1961/62 the estimates are based on "individual" recipient units, and in the case of 1953/54 and 1957/58 on "household" recipient units also.

The adjustments made by the ECAFE secretariat relate, in the main, to saving and dis-saving in certain income categories and to the allocation of the amount of tax evaded. Any hypothesis in regard to saving allocation must to some extent be arbitrary, and, in the absence of definite evidence, the choice among hypotheses must be governed by their relative plausibility. Zero savings are assumed below a certain income level in all years, as are negative savings as a fixed proportion of total savings. Two assumptions are made with regard to adjustments in personal income: (i) evaded tax payments are fully reflected in consumption and/or saving, and (ii) they are not reflected at all. In the first case no adjustment is

called for. In the second case, consumption in each decile is adjusted by deducting "excess" consumption, and, thereafter, the amount of tax evasion is added to the disposable income of the tax-paying classes.

The two alternative assumptions with regard to distribution of savings and evaded tax payments are combined so that the estimates of income distribution and measures of inequality have a maximum and a minimum value. It is believed that, in view of the conjectural nature of the assumptions, the procedure of presenting the estimates in the form of a range is more plausible than the alternative of presenting a single estimate.

The results of this work and of the earlier studies are presented in the accompanying tables. Tables I-3-2, I-3-3 and I-3-4 give distribution of personal income and tables I-3-5 and I-3-6 distribution of disposable income.

In view of the adjustments made in the allocation of saving and evaded income tax to various income brackets, the results of the ECAFE study of India are not strictly comparable with income distributions studies prepared by other countries. Moreover, the ECAFE study shows the income distribution pattern to be more unequal when the household is taken as the unit than when the individual is the unit, which contradicts the experience of other countries for which results based on both household and individual units are available. In fact, the results

Table I-3-2. INDIA: PATTERN OF PERSONAL INCOME DISTRIBUTION
AMONG HOUSEHOLDS AND INDIVIDUALS

(in percentages)

Income group	Households			Individuals			Individuals		
	1953/54 to 1956/57			1953/54 and 1954/55			1961/62 and 1963/64		
	Rural sector	Urban sector	All India	Rural sector	Urban sector	All India	Rural sector	Urban sector	All India
1st decile	4	3	3	4	2	3	3	2	2
2nd decile	5	4	5	4	3	4	4	4	3
3rd decile	6	6	6	5	4	5	6	4	4
4th decile	7	6	6	5	5	5	7	5	5
5th decile	8	6	8	8	6	6	8	6	6
6th decile	9	8	8	8	7	8	9	6	7
7th decile	9	8	9	10	7	9	9	7	8
8th decile	13	10	13	11	11	11	11	9	11
9th decile	14	12	14	15	16	14	18	12	14
10th decile	25	37	28	30	39	35	25	45	40
Total	100	100	100	100	100	100	100	100	100

Sources: See sources to table I-3-4.

Table I-3-3. INDIA: PATTERN OF PERSONAL INCOME DISTRIBUTION AMONG INDIVIDUALS
(in percentages)

Income group	1953/54 ^a			1953/54 ^b			1961/62 ^a			1961/62 ^b		
	Rural sector	Urban sector	All India	Rural sector	Urban sector	All India	Rural sector	Urban sector	All India	Rural sector	Urban sector	All India
1st decile	4	3	3	4	2	3	4	3	3	4	2	3
2nd decile	4	3	4	4	3	4	5	3	4	5	3	4
3rd decile	6	4	5	5	4	5	6	4	5	6	4	5
4th decile	6	5	6	6	5	6	7	5	6	6	4	6
5th decile	7	6	7	7	6	7	7	6	7	7	5	6
6th decile	9	7	8	8	6	8	9	6	8	9	5	8
7th decile	10	9	10	10	8	9	10	6	9	10	5	9
8th decile	12	10	12	12	9	11	11	14	11	11	11	11
9th decile	15	19	16	16	18	16	15	18	17	15	21	16
10th decile	27	34	29	24	39	31	26	35	30	27	40	32
Total	100	100	100	100	100	100	100	100	100	100	100	100

Sources: See sources to table I-3-4.

^a Estimates combine the assumption of zero savings below a certain income level with the assumption that evaded tax payments are fully reflected in consumption and/or savings.

^b Estimates combine the assumption of negative savings below a certain income level with the assumption that evaded tax payments are not reflected at all in consumption and/or savings.

Table I-3-4. INDIA: PATTERN OF PERSONAL INCOME DISTRIBUTION AMONG HOUSEHOLDS
(in percentages)

Income group	1953/54 ^a			1953/54 ^b			1957/58 ^a			1957/58 ^b		
	Rural sector	Urban sector	All India	Rural sector	Urban sector	All India	Rural sector	Urban sector	All India	Rural sector	Urban sector	All India
1st decile	2	2	2	2	2	2	2	2	2	2	2	2
2nd decile	3	3	3	3	3	3	3	3	3	3	2	3
3rd decile	4	4	4	4	3	4	4	4	4	5	3	4
4th decile	6	5	5	6	4	5	6	4	5	6	4	5
5th decile	7	5	6	6	5	6	7	5	6	7	5	6
6th decile	8	7	8	8	6	7	8	6	8	8	6	7
7th decile	9	8	9	9	8	9	10	8	9	9	7	9
8th decile	12	10	12	12	10	11	12	10	12	12	9	11
9th decile	16	16	16	16	13	16	16	19	17	16	12	16
10th decile	33	40	35	34	46	37	32	39	34	32	50	37
Total	100	100	100	100	100	100	100	100	100	100	100	100

Sources: 1. Ojha, P. D. and Bhatt, V. V., "Pattern of income distribution in India: 1953-54 to 1956-57", *Reserve Bank of India Bulletin*, September 1963.

2. Ojha, P. D. and Bhatt, V. V., "Pattern of income distribution in India: 1953-55 to 1961-64", paper presented at the Seminar on Income Distribution organized by the Indian Statistical Institute, New Delhi, February 1971.

3. ECAFE, "Distribution of income and wealth in India", document EGPT.8/ID/4 (mimeographed), 1971.

^a Estimates combine the assumption of zero savings below a certain income level with the assumption that evaded tax payments are fully reflected in consumption and/or savings.

^b Estimates combine the assumption of negative savings below a certain income level with the assumption that evaded tax payments are not reflected at all in consumption and/or savings.

Table I-3-5. INDIA: PATTERN OF DISPOSABLE PERSONAL INCOME DISTRIBUTION AMONG INDIVIDUALS
(in percentages)

Income group	1953/54 and 1954/55			1961/62 and 1962/64			1953/54 ^a			1961/62 ^a			1961/62 ^b		
	Rural sector	Urban sector	All India	Rural sector	Urban sector	All India	Rural sector	Urban sector	All India	Rural sector	Urban sector	All India	Rural sector	Urban sector	All India
1st decile	4	3	3	3	2	3	4	3	3	4	3	4	4	2	3
2nd decile	4	4	4	4	4	4	5	4	4	5	4	4	5	3	4
3rd decile	5	4	5	6	4	6	6	5	5	6	4	5	6	4	5
4th decile	5	5	5	7	5	6	6	6	6	7	5	6	6	4	6
5th decile	8	5	5	8	6	7	7	6	7	7	6	7	7	5	7
6th decile	8	8	9	9	7	7	9	7	8	8	6	8	9	6	8
7th decile	10	8	8	9	7	9	10	9	10	10	8	9	10	6	9
8th decile	12	11	11	12	10	11	12	10	12	12	10	12	11	12	11
9th decile	15	15	16	18	12	12	15	19	16	16	18	16	15	20	16
10th decile	29	37	34	24	43	35	26	32	29	28	37	30	26	38	31
Total	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100

Sources: See sources to table I-3-4.

^a Estimates combine the assumption of zero savings below a certain income level with the assumption that evaded tax payments are fully reflected in consumption and/or savings.

^b Estimates combine the assumption of negative savings below a certain income level with the assumption that evaded tax payments are not reflected at all in consumption and/or savings.

Table I-3-6. INDIA: PATTERN OF DISPOSABLE PERSONAL INCOME DISTRIBUTION AMONG HOUSEHOLDS
(in percentages)

Income group	1953/54 to 1956/57			1953/54 ^a			1953/54 ^b			1957/58 ^a			1957/58 ^b		
	Rural sector	Urban sector	All India	Rural sector	Urban sector	All India	Rural sector	Urban sector	All India	Rural sector	Urban sector	All India	Rural sector	Urban sector	All India
1st decile	4	4	3	2	2	2	2	2	2	?	2	2	2	2	2
2nd decile	5	4	5	3	3	3	3	3	3	3	3	3	3	3	3
3rd decile	5	4	6	4	4	4	4	4	4	4	4	4	5	3	4
4th decile	7	7	6	6	5	5	6	4	5	6	5	5	6	4	5
5th decile	9	7	8	7	5	7	7	5	6	8	5	7	7	5	6
6th decile	9	8	9	8	7	8	8	6	7	8	7	8	8	6	7
7th decile	10	8	9	10	8	9	9	8	9	10	8	9	9	7	9
8th decile	12	11	12	12	11	12	12	10	12	12	10	12	12	9	11
9th decile	14	11	14	16	17	16	16	13	16	16	19	17	16	12	16
10th decile	25	36	28	33	38	34	34	45	36	31	37	33	32	49	37
Total	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100

Sources: See sources to table I-3-4.

^a Estimates combine the assumption of zero savings below a certain income level with the assumption that evaded tax payments are fully reflected in consumption and/or savings.

^b Estimates combine the assumption of negative savings below a certain income level with the assumption that evaded tax payments are not reflected at all in consumption and/or savings.

of the earlier Indian study conform to experience elsewhere; when the household is taken as the unit, the income distribution pattern which emerges is less unequal than the pattern based on the individual as unit. The concentration ratio works out higher for the latter in countries for which both sets of data are available.

Even though the ECAFE results are not strictly comparable with those derived from national data alone, the over-all concentration ratio does not differ greatly from that worked out in the earlier studies on income distribution in India. The broad trends revealed are similar in both studies.⁹

No data on income distribution for periods later than 1963/64 are available. It is quite possible that both the direction and the magnitude of the trends have changed since then, but, in the absence of any reliable data, no conclusions can be reached.

(f) Trends in rural income distribution

Income distribution in the rural sector, particularly in the farm sector, is closely linked with the distribution of land ownership. Data on land ownership in India are available for 1953/54 and 1960/61,¹⁰ but in view of the fact that different concepts and definitions of "operational holdings" were adopted in the two N.S.S. Surveys concerned, the results are not strictly comparable. The 1960/61 Survey revealed that farmers with 30 acres or more of holdings had about 3.4 per cent of total operational holdings and 25 per cent of the total area. Those with less than 10 acres had 82 per cent of total operational holdings and 39 per cent of total area. No data are available to indicate changes in the pattern of land ownership in recent years.

What is relevant from the point of view of income-yielding potential is the value of land, rather than its size (acreage). Accordingly, it is quite possible that, although wealth holding may be unequally distributed, income may be more equally distributed. In fact, income is more equally distributed in the rural sector than in the urban sector. There

are reasons to believe that, owing to the various technological changes which have taken place, particularly since 1965, in the farm sector, the distribution of income may have become somewhat more unequal in recent years.¹¹

(g) Reducing the inequality of income distribution

Since planning began in India in 1950, the reduction of inequalities in income and wealth has been one of the main planks of economic policy. The Constitution of India has specifically mentioned the role the State has to play in this respect. The opening years of the first five-year plan were years of adjustment to immediate post-partition conditions and the impact of the war in Korea. From 1954/55 to 1964/65, the economy experienced fairly steady growth. Measured by income, real national income grew at an annual compound rate of about 4 per cent; since population rose by something between 2.2 and 2.4 per cent, the increase in *per capita* income was modest—less than 2 per cent a year. The domestic saving-income ratio rose from 8 per cent (1954/55) to 12 per cent (1963/64). For a variety of reasons the economy suffered a series of setbacks in 1962/63 and 1965, in addition to drought setbacks in 1965/66 and 1966/67. The *per capita* income level in 1965 was about the same as that in 1960/61. The income growth rate decelerated after 1962/63. Since 1968/69 recovery has set in, and the fourth five-year plan is being implemented with effect from 1 April 1969. Agricultural and industrial growth rates have accelerated.

The considerable qualitative changes which have occurred in the economy in the last two decades are not adequately reflected in any of these growth statistics and they merit discussion in some detail. The State has been playing an effective role in the development process. Under the Constitution, compulsory primary education is to be introduced within a given period. Some States have been providing free education up to the secondary stage. Health facilities, too, are being expanded. The Government introduced land reforms with "ceilings" on land holdings in early 1950 and recognizes the need to strengthen these measures. Various other measures have been introduced in recent years to reduce concentration of

⁹ In another study, the Lorenz ratios for the years 1949/50, 1952/53, 1953/54 and 1956/57 are, respectively, 0.33, 0.30, 0.28, 0.29. See Mukherjee, M., *National Income of India: Trends and Structure*, Statistical Publishing Society, Calcutta, 1969, p. 324. These ratios, as well as those of Ojha and Bhatt, indicate that income distribution in India is not more unequal than that of some developed countries.

¹⁰ Government of India, Cabinet Secretariat, *The National Sample Survey*: (i) (a) 8th round (July 1954–April 1955), Nos. 30 and 36, Report on Land Holdings; (b) Operational Holdings in Rural India; (c) (Some Aspects of Ownership Holdings); (ii) 17th round (September 1961–July 1962), No. 144, Tables with notes on some aspects of landholdings in rural areas; (iii) 16th round (July 1960–June 1961), 113, Tables with notes on agricultural holdings in rural India. See also Tarlok Singh, "Planning technological change in Indian agriculture", *International Social Science Journal*, Vol. XXI, No. 2, 1969, pp. 265–271.

¹¹ The impact of the "green revolution" on income distribution has not yet been fully analysed, but some studies have been attempted. It is believed that this phenomenon may initially tend to increase income inequality, but, subsequently, through increased employment opportunities created by the multiple-cropping pattern, distribution may tend to become more equal. See, on this subject, Abel, Martin E., "Differential rates of growth in rural incomes resulting from specific government policies like the new agricultural strategy", paper presented at a Seminar on Income Distribution in India, New Delhi, 1971; and Vyas, V. S., and others, *Significance of the New Strategy of Agricultural Development for Small Farmers*, Agro-Economic Research Centre, Sardar Patel University, Vallabh Vidyanagar, 1969.

wealth and economic power, among them the Monopolies and Restrictive Trade Practices Act and the Monopolies and Restrictive Trade Practices Commission. Specific programmes to benefit small farmers, the educated unemployed, and farmers with dry land have been introduced.¹² Most commercial banking is nationalized, and efforts are being made to increase the accessibility of banking services to the public. Credit facilities and banking services are being extended to hitherto neglected sectors, and measures have been adopted to mobilize savings, particularly small savings in the rural sector. Furthermore, several redistributive taxes, such as wealth tax, additional wealth tax on lands and buildings, gift tax, estate duty, and progressive income tax have been imposed. The Government has also announced its intention to impose a "ceiling" on urban wealth.

All these factors tend to reduce the inequality of income distribution, but some of them will show visible results only in the long run. Among the most important factors contributing to the movement toward more equal distribution of personal income is the increase in government employment, in which dispersion is smaller than in the business sector. Other factors include a relative decline in the importance of farming and an upward shift in the mean agricultural income, which brings it closer to the mean non-agricultural income; the latter factor, however, is still not significant.

Philippines

(a) Source of data

For this study, extensive use was made of the family income and expenditure surveys conducted by the Bureau of Census and Statistics for 1956-1957, 1961 and 1967; the tax burden study undertaken by the Joint Legislative-Executive Tax Commission in 1960, and various individual research findings.

(b) Distribution of families by income group

The pattern of family income distribution showed an extreme imbalance throughout the period considered. The bulk of the nation's income is concentrated in the hands of the high-income groups.

The first finding was that the average level of family income is very low. In 1956, the average income per household was 1,471 pesos; by 1965, a decade later, it had gone up to 2,541 pesos. When corrected for price increases during the period, the average income of 2,541 pesos in 1965 was equivalent to 1,847 pesos' worth of goods and services in 1956.

Extreme disparity in the distribution of income was most evident at the household level. The proportion of total income received by roughly three-fourths of the country's families is only between one-third and four-tenths. Significantly, about one-fifth of all families earned less than 500 pesos a year. On the other hand, the top 10 per cent of income-earners received about 40 per cent of the country's total income during the period 1956 to 1965, although there were slight variations in the specific percentage. No less significant is the finding that the top 5 per cent of family income recipients in the country consistently accounted for about 27 per cent of total income during the same period. For the same period, the bottom 20 per cent of income-earners continued to receive less than 5 per cent of total income and the bottom tenth less than 2 per cent.

The proportion of families with incomes under 1,000 pesos was reduced by almost one-half from 54.8 per cent in 1956 to 29.3 per cent in 1965. On the other hand, the proportion of families receiving at least 3,000 pesos more than doubled, rising from 9.6 per cent to 23.0 per cent in 1965. The relative share of the 1,000-2,999 pesos group increased from 35.6 per cent to 47.7 per cent, largely through the transfer to it of families from the under-1,000 pesos group.

Over the period, the general trend reflects a gradual diminution in the number of families at the lower end of the income distribution and a corresponding increase in the number of families in the upper tail. The proportion of families at the lower end declined by about 3.7 per cent during the period, while the proportion at the upper end rose by 12.9 per cent. This general trend was observed in both rural and urban areas.

During the 1956-1965 period, slight gains were achieved by the upper half of the ranked groups in their shares of total income. Throughout these years the top 5 per cent of income-earners shared close to 30 per cent of the country's total income (see table 1.3-7). Equally significant is the finding that more than half of the total income went to only one-fifth of all the families in the country. In 1965, 16 per cent of families received only 1.2 per cent of total family income, as compared with 2.1 per cent in 1956. At least one-half of the country's families were then sharing only about 17 per cent of total family income, and, from 1956 to 1965, there was a gradual decline in their share of total income from 18.5 to 17.8 per cent. During the same period, the share of the top 20 per cent of income-earners dropped from 56.2 to 55.4 per cent, with a corresponding increase in the relative shares of the middle income-earners. Moreover, the situation in 1965 was still favourable

¹² See *Fourth Five-Year Plan, 1969-1974*, Government of India, New Delhi.

for the top 40 per cent of income-earners but worse for the low income groups than in 1956.

(c) Rural-urban disparities

In 1965 there were about as many families receiving incomes under 1,000 pesos as there were families with incomes of at least 3,000 pesos. When families are grouped into rural and urban categories, however, the disparity in distribution between the low and high income groups becomes more apparent. In the rural sector, 36.4 per cent of families fell within the lower income group and only 14.5 per cent within the upper group. The opposite situation prevailed in urban areas, where only 22.4 per cent of families received under 1,000 pesos, while 43.1 per cent earned at least 3,000 pesos. It is interesting to note that, in 1965, almost one-half of rural families were in the middle-income group (1,000-2,999 pesos), while only about one-third of urban families fell within this income bracket.

During the period from 1956 to 1965, the growth in average income in rural areas of the country was generally accompanied by a gradual narrowing of income disparity. In urban areas, on the other hand, the growth of average income went hand-in-hand with a widening of the gap between low and high income groups. Thus, the over-all effect on families of the observed "changes" in income distribution was in the nature of an upward shift of average income, rather than an "equalization" of income distribution among all families in the country. For this reason there still existed in 1965 a wide disparity in income distribution between rural and urban families, as well as between low and high income groups. The same general trend is confirmed by comparing the income share of families, arranged by ordinal groups from the highest to the lowest income recipients, for the period 1956-1965.

Table I-3-7. PHILIPPINES: FAMILY INCOME DISTRIBUTION BY ORDINAL GROUP, 1956, 1961 AND 1965

Family income recipients	Percentage of total income		
	1956	1961	1965
Top 5 per cent	27.0	28.9	27.6
Top tenth	39.3	40.7	40.0
2nd tenth	15.6	15.5	15.4
3rd tenth	11.2	10.7	11.5
4th tenth	8.3	8.4	8.9
5th tenth	7.1	6.8	6.9
6th tenth	5.8	5.1	5.6
7th tenth	4.2	4.1	5.0
8th tenth	3.8	4.1	2.9
9th tenth	2.6	2.6	2.7
Bottom tenth	2.1	2.0	1.2

Source: ECAFE, "Distribution of Income and Wealth in the Philippines", document EGPT.8/ID/5 (mimeographed), 1971.

(d) The concentration ratios

The aggregate concentration ratios for family income distributions in the Philippines for the three selected years and for rural and urban families separately are shown below:

	Concentration ratios		
	1956	1961	1965
Philippines	0.492	0.515	0.516
Rural	0.397	0.409	0.429
Urban	0.502	0.523	0.532

The increase in the value of the concentration ratio from 0.492 in 1956 to 0.516 in 1965 is further proof of the fact that the distribution of family income in the country became more unequal over that period. The sharp rise in the value of the ratio for both urban and rural families confirms earlier findings that this behaviour of income inequality over time is common to all areas of the country and that income inequality is consistently more pronounced in urban areas.

Significantly, the rate of departure from equality was relatively faster for urban families during the period from 1956 to 1961 than in the period from 1961 to 1965. On the other hand, the rate of departure from equality for rural families was faster over the period from 1961 to 1965 than for the earlier period.

(e) Regional disparities

There is disparity in the income of the urban and rural populations. The average income of families in rural areas was barely half of that of their urban counterparts. Income inequalities also exist between regions. For all the survey years (1956, 1961 and 1965), families in the metropolitan Manila area reported the highest average incomes. The "re-radiation" effect of industrialization and development was apparent in the observed trend towards decreasing incomes as distance from the centres of development increased.

(f) Causes of income inequality

Income inequality in the Philippines is caused, basically, by two factors. The first is the under-developed character of the economy, as manifested by low aggregate productivity and the high rate of population growth (3.1 per cent), which accentuates the ubiquitous poverty. The second factor is really a composite of such institutional features as concentrated private property ownership and powerful family corporations. Data on distribution of wealth and

land holdings are not available, but income from property is known to account for a significant portion of the national income. During the period from 1946 to 1970, income from property accounted for some 10 to 13 per cent of national income, the percentage rising steadily throughout those years. The national Constitution considers private property as inviolable as life and liberty. Thus, the revenue that the country collects from inheritance taxes represents only 2.6 per cent of all direct tax revenue and has had hardly any redistributive effect. Family corporations, a prime source of income inequality in the Philippines, are deeply rooted in the country's social mores; indeed, close family ties are a basic feature of the social system. In the rural sector, according to the 1960 Agricultural Census, about 865,000 farms, representing 40 per cent of the total, were operated by tenants, and 86.2 per cent of all tenant-operated farms were operated by share-croppers.

(g) *Government policies with respect to income distribution*

The economic growth rate of the Philippines stabilized during the last half of the 1950s at 5.0 per cent and rose to 5.6 per cent in 1960-1965 and 7.0 per cent in 1965-1970. Over the last 25 years, gross domestic capital formation has averaged about 17 per cent annually. The widening in the wealth and income gap among the country's households has not, it is believed, led to greater investment, if the great number of investment incentives being offered is any indication.

In an economy such as that of the Philippines, planning objectives are pursued through fiscal and monetary instruments. The country's fiscal system, though fairly successful in raising revenue, has failed to bring about a more equal distribution of wealth and income, as the figures below indicate:

Distribution of income in the Philippines
before and after taxes, 1960

Cumulative percentage of households	Cumulative percentage of income			
	Before taxes	After taxes		
		All sources	Direct	Indirect
Lower 20 per cent .	4.2	4.6	4.9	3.9
Lower 50 per cent .	17.3	17.9	18.2	16.7
Lower 90 per cent .	57.8	59.7	60.2	57.2
Upper 10 per cent .	42.2	40.3	39.8	42.8

Source: Joint Legislative-Executive Tax Commission, *The Study on Tax Burden by Income Class*, 1961.

There is evidence that, in the decades considered, the Government experienced heavy budgetary deficits,

which led to monetary expansion (and pressure on the balance of payments) and consequently created an inflationary situation, with adverse effects on distribution of income. The degree to which this inflationary pressure was planned is not known.

As in other developing countries, the increase in government expenditure on education, health, housing and social welfare has not kept pace with rapidly growing needs. Education, too, has been a basic contributor to income inequality because of the unequal opportunities for full and good education; this situation is aggravated by a high drop-out rate in public elementary schools. About one-fourth of the 1957 labour force, for example, was reported to be illiterate. The net effect is limited educational opportunities and, hence, decreased earning capabilities, for a large segment of the population.

Thailand

(a) *Sources of data and methodology*

Data on Thai income and wealth are scarce and, where available, fragmentary. The main sources of information on family income and consumption are the *Household Expenditure Surveys*, published by the National Statistical Office. Three surveys have been conducted, in 1958, 1962/63 and 1970. The 1958 Survey covers only municipal area households in Bangkok and some provincial towns selected to represent their regions. The 1962/63 Survey had a wider coverage, since non-municipal as well as municipal areas were sampled. The results of the 1970 Survey have not yet been published, but some preliminary data were obtained from the National Statistical Office for use in this chapter.

Information on the distribution of income and on land ownership among farmers can be obtained from reports on farm management surveys conducted by such government agencies as the Division of Agricultural Economics, of the Ministry of Agriculture, the Department of Land Development of Kasetsart University, and the Department of Land Co-operatives.

National income accounts data used in this study are the latest estimates by the National Economic Development Board, which were unpublished at the time of writing but were made available for the use of ECAFE. Regional income data are only available for the North and North-East regions.

The definition of income used in the analysis is that applied by the National Statistical Office in its Surveys. Family income is defined as the total receipts of the household during one year, or, in some

instances, one month. Receipts are deemed to include compensation for work effort, receipts for the use of property, gifts and transfers. The definition of individual income in the Revenue Code includes receipts in kind and in cash but excludes pensions, gifts and transfers.

(b) *Unit of study*

Both "family" and "individual" units of income recipient are used in this paper, depending on the source of data. In the *Household Expenditure Survey*, the family unit is defined as a group of two or more persons residing in the same living unit and spending from a common household budget.

There is one problem in connexion with the size of the family unit. Family size appears to be positively correlated with income among both urban and rural families. Ideally, family income should be adjusted within each income class to take account of the influence of family size on income. The survey data, however, have no usable information on family size. It has accordingly had to be assumed that the relative size of families within a given set of data, e.g. urban or rural, did not change significantly during the period of observation; in other words, the data used are unadjusted for family size. In making

inter-group comparisons, such as between urban and rural groups, it will have to be borne in mind that the relationship between income and family size may differ so significantly within specific groups as to affect any conclusion drawn.

Of the three sets of Survey data available, the data for the latter two periods, although not as uniform as might be desired, are at least comparable, whereas the range of the 1958 Survey is such as to make it quite unsuitable for the purposes of this chapter; accordingly, only the 1962/63 and 1970 Survey results have been used, on the understanding that they provide a broad indication of the pattern of income distribution, rather than any precise measure of it. The income shares of different income groups in urban and rural areas are shown in table I-3-8.

(c) *Pattern of income distribution:
urban families*

It appears that the size distribution of income of urban families shows a trend towards greater equality. The concentration ratio decreased from 44.78 to 36.64. The income share of the bottom 20 per cent of families increased from 3.5 to 6.5 per cent of total income. Other classes in the middle

Table I-3-8. THAILAND: PATTERN OF PERSONAL INCOME DISTRIBUTION
(WITH HOUSEHOLD AS INCOME RECIPIENT UNIT)

Income group	1962/63				1970	
	Rural ^a	Urban ^a	Rural ^b	Urban ^b	Rural ^a	Urban ^a
1st decile	3.0	1.5	2.5	2.0	2.5	2.5
2nd decile	3.0	2.0	3.5	2.5	3.0	4.0
3rd decile	3.5	4.5	3.5	4.5	3.5	5.0
4th decile	5.5	5.0	4.5	6.5	5.0	5.5
5th decile	6.0	6.5	5.5	7.0	6.5	6.5
6th decile	7.5	7.5	6.5	8.5	7.5	8.5
7th decile	9.0	9.5	9.0	11.0	9.5	10.0
8th decile	11.5	13.0	11.5	15.0	11.5	12.5
9th decile	17.0	15.5	18.0	18.0	16.5	16.0
10th decile	34.0	35.0	35.5	25.0	34.5	29.5
All groups	100.0	100.0	100.0	100.0	100.0	100.0
Bottom 20 per cent	6.0	3.5	6.0	4.5	5.5	6.5
Bottom 40 per cent	15.0	13.0	14.0	15.5	14.0	17.0
Bottom 60 per cent	28.5	27.0	26.0	31.0	28.0	32.0
Top 20 per cent	51.0	50.5	53.5	43.0	51.0	45.0
Top 10 per cent	34.0	35.0	35.5	25.0	34.5	29.0
Top 5 per cent	22.0	23.0	22.5	12.5	22.0	16.0

Source: ECAFE, "Distribution of Income and Wealth in Thailand", document EGPT.8/ID/6 (mimeographed), 1971.

^a Unadjusted.

^b Adjusted for size differences between rural and urban households.

range also gained, but the percentage gains are smaller. Only the top two or three classes show a reduction in their percentage income share, the richest families, in particular, having their income share decline from 35 to 29 per cent of the total income of the society.

(d) *Distribution of income: rural families*

There appears to have been little change in the pattern of income distribution among the rural population. The share of the lower income brackets declined, as did that of the top income brackets, the gainers being the middle-income families (table I-3-8). The concentration ratio works out at 0.44 for both 1970 and 1962/63. The concentration ratio for 1962/63 is slightly lower than that for the urban area (0.45) in the same year. This broadly conforms to other findings, which indicate that distribution is more unequal in urban than in rural areas.

The cause of the relatively stable pattern of income distribution among rural families may be that the occupational structure of the rural economy has changed much less than that of the urban economy. Agricultural diversification and double-cropping practices may account for the increasing income share of the middle-income rural families. Observations as yet untested suggest that farmers in the middle-income groups are generally more willing to accept new technology and more responsive to market forces than other groups.

(e) *Rural-urban differentials*

The following figures show the mean income of urban and rural families:

Year	Mean income of rural families	Mean income of urban families	Ratio of rural/urban incomes
1962/63	4,820 baht	11,341 baht	42.50 per cent
1970	8,806 baht	21,608 baht	40.77 per cent

The figures show that the urban-rural income differential is getting wider; the income of rural families has decreased from 42.50 per cent to 40.77 per cent of the average income of urban families.

A full comparison, however, demands some adjustments to the average income of the various income classes in order to eliminate the influence of family size. It seemed appropriate to assume for purposes of comparison that the size of the family in any income bracket of the rural population is the same as

that occurring in the urban population, and the data for rural family income were adjusted accordingly. Only the information on family size from the 1962/63 Survey results was used, as the 1970 Survey results are not yet available; the result is "adjusted distribution" in table I-3-8.

The resulting comparison shows that the average family income of the rural population is less than half of that of the urban population. The distributions also show a higher degree of inequality among rural families. The lowest income brackets in rural areas appear, however, to have a slightly larger share of income than do the urban poor, but, in the middle-income classes, rural families seem to have smaller shares than urban families.

(f) *Distribution of wealth: rural areas*

One of the most important forms of wealth in rural areas is agricultural land. In the 1963 *Census of Agriculture* the National Statistical Office makes a distinction between land holding and ownership. The term "holding" refers to all parcels of land utilized in farm operations under the management of a single holder or farm operator, regardless of occupation right. A "holding" is therefore a "farm", and the size of the holding is the size of the farming unit. The term "land owned" refers to any land in the holding that legally belongs to the farm operator and is being cultivated by him. Holdings therefore include both land owned and land rented.

Data are available on the distribution of holdings and on the distribution of land owned by size of holding. The bottom 10 per cent of farms by size account for only 1 per cent of the total land area, while the top 10 per cent hold 34 per cent of all land. The bottom 60 per cent hold 25 per cent, and the top 5 per cent 21 per cent of all land. Concentration ratios work out to 0.48 for land holdings and 0.46 for land owned. There is therefore a higher degree of concentration in the distribution of land holdings than in land owned.

(g) *Income distribution and land ownership: rice farmers*

There appears to be somewhat less concentration of income among rice farmers than in the rural sector as a whole, owing apparently to greater crop diversification on smaller farms. The high degree of inequality of family income within the rural sector may be largely accounted for by variations in the crops and livestock produced by farmers of different regions; among growers of the same crop a more uniform economic status might be expected.

Information on the distribution of land ownership in 1965, by size of holding, among rice farmers in eleven provinces in the central plain shows that the top 20 per cent had 34 per cent of all the land concerned, while the bottom 60 per cent had 40 per cent. The concentration ratio worked out at 0.27.¹³

Concentration of land ownership is relatively low; an interesting point is that it is less than the distribution of family farm income. This fact suggests that the size of holding is not a decisive factor in determining the size of income from farming. Such factors as soil fertility, the use of fertilizers and cultivation methods may be equally important.

(h) *Over-all concentration ratio*

In the ECAFE study the over-all concentration ratio could not be calculated. Another source¹⁴ offers a figure of 0.50, which is higher than that for either Ceylon or India. Income distribution after tax is not given, and distributions of income by sex, education, age and functional categories are not available.

(i) *Factors promoting equality*

Factors operating to produce more equality are the rising share of income of employees (28 per cent in 1960 and 30 per cent in 1969) and the decreasing share of income from property (9.45 per cent in 1960 and 9.22 per cent in 1969). However, since income from non-incorporated enterprises is substantial (58.36 per cent in 1969), a tendency toward inequality may also exist. Price mark-ups may be high and mobility much less in such enterprises.¹⁵ The rise in the share of corporate profits (from 1.55 per cent in 1960 to 3.66 per cent in 1969) will have the same effect of raising inequality.

There is a considerable range between the top skilled wage rates and the bottom unskilled wage rates (about five times). The relatively wide discrepancy between wage rates of the top occupations and the bottom occupations suggest that economic mobility is not high. However, much more detailed information is required before any proper evaluation of occupational mobility can be made.

It has been found that geographical mobility is relatively high. It is believed that age, education and training significantly affect the geographical mobility of workers. The younger and more educated tend to be more mobile. In a study by the Department of Labour it was found that workers with secondary education tended to look for jobs only in urban areas while those with lower education tended to prefer construction jobs or employment in small business regardless of location.¹⁶

(j) *Education and equality*

The National Education Council has reported that over 60 per cent of pupils drop out of school between the "early primary" and "advanced primary" levels. Thereafter, about half the number drops at each level until only 2.3 per cent are left at university level. Secondary school graduates are the main source of new entrants into the skilled labour force and subsequently occupy the middle income brackets. As it is, over 80 per cent of children leave school at primary level to enter the job market. Those with primary school education can hope only for relatively unskilled, low-paid jobs; they will therefore tend to stay in the same income group as their parents, and it is believed that 80 per cent of them do so. At the university level, inequality of opportunity still exists. It has been found that children from upper middle-class families have a much higher probability of being admitted to a university than children from the poorer rural families. Failure to equalize educational and training facilities thus tends to strengthen the tendency towards inequality.

(k) *Regional inequality*

There are wide differences in the *per capita* incomes of the regions. The central region has the highest *per capita* income, more than 50 per cent above the national average, while the northeast has the lowest *per capita* income, at about half the national average. *Per capita* income in the central and northern regions is definitely moving upwards while that of the northeast shows a declining trend. The trend is towards even wider regional differences. The central region shows the most rapid growth in *per capita* income; the northeast is the most stagnant.

¹³ The concentration ratio of land ownership of rice farmers in the Chainart sample was 0.31, compared with the concentration ratio of income of 0.35 for the same sample.

¹⁴ Oshima, Harry T., "Income inequality and economic growth", *The Malayan Economic Review*, October 1970, p. 13.

¹⁵ Oshima, *ibid.*, p. 25.

¹⁶ *Ibid.*; after working in Bangkok, peasants return to the provinces of the northern and northeastern regions after the slack farm seasons are over. If there were greater mobility, workers would move to cities with better opportunities of industrial jobs.

In the northeast, 94 per cent of the labour force (well above the national average) is engaged in agriculture, where productivity is the lowest. In the central region, only 76 per cent of the labour force is employed in agriculture (a figure below the national average). Furthermore, the northeast has the smallest proportion of labour force working in the electricity and manufacturing sectors, which has the highest average output per worker. All this partly explains the relative poverty of some regions.

The percentage of all government spending devoted to health and social services is declining. The level of government spending on public health in Thailand is believed to be among the lowest in the world, even by the standard of underdeveloped countries. Hospitals and medical facilities are predominantly concentrated in the urban centres and thinly spread over the whole country. The only progressive direct tax in Thailand is the income tax, which appears to be widely evaded and has, at any rate, a low rate of graduation and a low maximum tax rate.

International comparisons

In table I-3-9, concentration ratios for the agricultural and non-agricultural sectors are shown separately for selected countries. Broadly, these ratios show income to be less unequally distributed in rural than in urban areas, except in those countries in which the agricultural sector is highly capital-intensive.

Percentage shares of decile groups in personal income in selected countries are shown in table I-3-10. The shares of the top 5 per cent and the top 10 per cent in personal incomes seem to be similar in the underdeveloped countries (except Ceylon) and developed countries considered. In India, the share of top 10 per cent is lower than in any other country considered. Similarly, although the differences between the shares of the bottom 20 per cent in the developed and underdeveloped countries (excluding India) are not very sharp, India has the highest figure for this share of any of the countries shown in the table.

Table I-3-11 shows concentration ratios for both "individuals" and "households" for selected countries. When the "household" is taken as the income-receiving unit, income distribution appears more equal than when the individual is taken as the unit in countries for which both sets of data are available. The concentration ratio for India is lower than the ratios for Ceylon, Philippines, Thailand and even those for some of the developed countries considered. The disparity between the concentration ratios yielded

by the distributions of personal income and of disposable income is much wider in developed countries than in such underdeveloped countries as India; this suggests that direct taxation has been more effective in reducing the degree of inequality in income distribution in the developed countries than in underdeveloped countries.

Historical data on the income distribution patterns of selected countries are presented in table I-3-12. These data indicate a much greater degree of inequality in income distribution in the developed countries at an early stage of their development than that obtaining at present in these countries or in some of the underdeveloped countries. It may be speculated that in the early stages of economic development the pattern of income distribution probably becomes more uneven, and the trend towards greater equality establishes itself only at a stage of the economic development process.

Table I-3-9. PATTERN OF INCOME DISTRIBUTION IN THE AGRICULTURAL AND NON-AGRICULTURAL SECTORS IN SELECTED COUNTRIES

(concentration ratios)

Country	Year	Agricultural sector	Non-agricultural sector
India ^a	1953/54 to 1956/57	0.31	0.40
	1953/54	0.42-0.43	0.48-0.51
	1957/58	0.41-0.42	0.49-0.54
Ceylon ^b	1952/53	0.45	0.52
Philippines	1956	0.397	0.502
	1961	0.409	0.523
	1965	0.429	0.523
Thailand	1962/63	0.44	0.45
Puerto Rico ^c	1953	0.32	0.43
Poland	1929	0.35	0.50
Italy	1948	0.41	0.40
Germany (Fed. Rep.)	1928	0.19	0.35
Netherlands	1954	0.22	0.29
Sweden	1959	0.36	0.39
United States	1950-1953	0.41	0.34

- Sources: 1. Kuznets, Simon, "Quantitative Aspects of the Economic Growth of Nations: VIII: Distribution of Income by Size", *Economic Development and Cultural Change*, January 1963, Part II, table 14, pp. 50-53.
2. ECAFE, "Distribution of income and wealth in Ceylon, India, Thailand and the Philippines", documents EGPT.8/ID/2, 4, 5 and 6 (mimeographed), 1971.
3. Ojha, P. D., and Bhatt, V. V., *op. cit.* in table 4.

^a For India and the Philippines, the agricultural sector corresponds to the rural sector, and the non-agricultural sector to the urban sector.

^b Agricultural sector includes hunting and fishing.

^c Agricultural sector includes forestry and fishing.

Table I-3-10. PERCENTAGE SHARES OF DECILE GROUPS IN
PERSONAL INCOME IN SELECTED COUNTRIES

Country	Year	Share of decile groups				
		Bottom 20%	Bottom 60%	Top 20%	Top 10%	Top 5%
India	1953/1954 to 1956/1957 ^a	8.0	36.0	42.0	28.0	—
	1953/1954 and 1954/1955 ^b	7.0	31.0	49.0	35.0	—
	1961/1962 and 1964/1965 ^b	5.0	27.0	54.0	40.0	—
	1953/1954 ^{b, c}	7.0	33.0	45.0	29.0	—
	1953/1954 ^{a, c}	5.0	28.0	51.0	35.0	—
	1957/1958 ^{a, c}	5.0	28.0	51.0	34.0	—
	1961/1962 ^{b, c}	7.0	33.0	47.0	30.0	—
Ceylon	1953 ^a	5.2	27.8	53.8	40.6	—
	1963 ^a	4.5	27.5	52.3	36.8	—
Philippines	1956	4.7	25.6	54.9	39.3	27.0
	1961	4.6	24.7	56.2	40.7	28.9
	1965	3.9	24.3	55.4	40.0	27.6
United Kingdom	1951/1952	5.4	33.3	44.5	30.2	20.9
Germany (Fed. Rep.)	1950	4.0	29.0	48.0	34.0	23.6
Netherlands	1950	4.2	29.5	49.0	35.0	24.6
Denmark	1952	3.4	29.5	47.0	30.7	20.1
Sweden	1948	3.2	29.1	46.6	30.3	20.1
United States	1950	4.8	32.0	45.7	30.3	20.4

- Sources: 1. Ojha, P. H., and Bhatt, V. V., "Pattern of income distribution in India: 1953-1954 to 1956-1957", *Reserve Bank of India Bulletin*, September 1963.
2. Ojha, P. D., and Bhatt, V. V., "Pattern of income distribution in India: 1953-1955 to 1961-1964", paper presented at the seminar on Income Distribution organized by the Indian Statistical Institute, New Delhi, February 1971.
3. ECAFE, "Distribution of income and wealth in India", document EGPT.8/ID/4 (mimeographed), 1971.
4. United Nations, *National Income and Its Distribution in Underdeveloped Countries*, Statistical Papers, Series E, No. 3, New York, 1951, p. 29.
5. United Nations, *Economic Survey of Europe in 1956* (United Nations publications, Sales No.: 1957.ILE.1), chapter IX, Economic Commission for Europe, table 3, p. 6.
6. Kuznets, Simon, *op. cit.* in table 9, table 3, pp. 13-15.
7. United States Department of Commerce, *Income Distribution in the United States*, Washington, 1953, table 21, p. 85.

^a Household as income recipient unit.

^b Individual as income recipient unit.

^c Estimates combine the assumption of zero savings below a certain income level with the assumption that evaded tax payments are fully reflected in consumption and/or savings.

Table I-3-11. PATTERN OF INCOME DISTRIBUTION
IN SELECTED COUNTRIES

(concentration ratios)

Country	Year	Personal income	
		Individual as income unit	Household as income unit
<i>Developing countries</i>			
Ceylon	1952/53	.500	.420
	1963	...	.450
China (Taiwan) .	1964	...	.360
India	1953/54 to 1954/55	.376	.349
	1961/62 and 1963/64	.385	...
Jamaica	1958	.560	.530
Philippines . .	1956	...	.492
	1961	...	.515
	1965	...	.516
Thailand	1962	...	.500
<i>Developed countries</i>			
Australia	1954/55	.350	...
Denmark	1952	.440	.370
Japan	1963	...	.350
Netherlands . .	1950	.450	.390
Norway	1950	.390	...
Sweden	1948	.440	.370
United Kingdom .	1955	.410	.330 ^a
United States . .	1959	...	.370

- Sources: 1. Kuznets, Simon, *op. cit.*, in tables 6 and 4, p. 18 (for Ceylon, Norway and Australia, col.)
2. Ahiram, E., "Income distribution Jamaica, 1958", *Social and Economic Studies*, Institute of Social and Economic Research, University of the West Indies, Jamaica, Vol. 13, No. 3, September 1964, table II, p. 346 (for Jamaica, cols. (2) and (3) and for Netherlands, Denmark and Sweden, col. (3) only).
3. United Nations, *Economic Survey of Europe in 1956, op. cit.*, chapter IX, p. 6 (for United Kingdom, Netherlands, Denmark and Sweden, col. (2)).
4. Ojha, P. D. and Bhatt, V. V., "Pattern of income distribution in India: 1953-54 to 1956-57", *Reserve Bank of India Bulletin*, September 1963 (for India, Ceylon (1952-53) and United Kingdom (col. 3)).
5. Oshima, Harry T., "Income inequality and economic growth: The post-war experience of Asian countries", *The Malayan Economic Review*, Vol. XV, No. 2, October 1970, table 1 (for Ceylon (1963), Thailand, China (Taiwan), Philippines, Japan and the United States)).
6. ECAFE, "Distribution of income and wealth in Ceylon, India and the Philippines", documents EGPT.8/ID/2, 4 and 5 (mimeographed), 1971.

^a For 1951/52.Table I-3-12. CHANGES IN THE PATTERN OF INCOME
DISTRIBUTION IN SELECTED COUNTRIES: PERCENTAGE
SHARE OF ORDINAL GROUPS, TAX UNITS OR
CONSUMING UNITS IN PERSONAL INCOME

Country	Year	Top 5%	Top 20%
United Kingdom . . .	1880	48.0	58.0
	1957	18.0	41.5
Germany: West Germany	1913	31.0	50.0
	1959	18.0	43.0
Denmark	1870	36.5	—
	1955	17.5	—
United States	1913-1919	24.0	—
	1944-1948	17.0	—
Japan	1930	10.4 ^a	above 52.0
India	1953/54	20.0	42.0
	to		
	1956/57	4.9 ^a	
	1953/54	35.0+ ^b	51
	1961/62	30.0+ ^b	47
Ceylon	1953	41.0+ ^b	54
		(18.2)	
	1953	37.0+ ^b	52
		(12.43)	
Philippines	1956	27.0	54.9
	1961	28.9	56.2
	1965	27.6	55.4

- Sources: 1. Kuznets, Simon, *op. cit.*, in table I-3-9, table 16, pp. 60-64.
2. Lockwood, William W., *The Economic Development of Japan*, Princeton, 1954, table 23, p. 272.
3. Ojha, P. D., and Bhatt, V. V., "Distribution of income in the Indian economy, 1953-54 to 1956-57", *Reserve Bank of India Bulletin*, September 1962.
4. ECAFE, *op. cit.*, in table I-3-11.

Note: Figures in brackets represent share of top 1 per cent.

^a Share of top 0.2 per cent.^b + Represents share of top 10 per cent.

C. Some aspects of income distribution in the ECAFE region

Measures of absolute level of poverty

Concentration ratios do not reflect absolute levels of poverty. For instance, countries such as Japan, the United States, and India have broadly similar concentration ratios, although the *per capita* income of many developing countries of the ECAFE region is about one-fortieth and that of Japan one-fourth of the figure for the United States. The concentration ratios for Ceylon, the Philippines and Thailand are

very similar, although their *per capita* incomes vary: \$160 in Ceylon, \$180 in the Philippines and \$130 in Thailand.¹⁷

The shares of the top group in total personal income do not seem to vary from one country to another, nor does there appear to be any meaningful correlation between levels of *per capita* income and the shares of the top income groups.

There are various shortcomings inherent in the concept of income inequality used for the purpose of measuring poverty. Income inequality measures represent, at best, only the relative position of a household in the aggregate income hierarchy. These do not reflect the absolute purchasing power or real welfare of a family. Relative poverty (though not to the same degree as in the developing countries) is known to exist even in affluent societies such as the United States. Data on income inequality thus cannot measure the absolute level of poverty in a society.

Recently, attempts have been made to measure "poverty" in terms of food consumption in relation to some reasonable norm, with a view to identifying absolute levels of poverty.¹⁸ In such approaches to the problem it is held that, for developing countries, the vital question is to provide the vast majority of the people with the basic necessities of life. What is most needed, particularly in underdeveloped economies, is a measure of absolute levels of poverty, not relative poverty or inequality. Much more work needs to be done before a meaningful policy framework for attacking this problem can emerge.

Factors influencing income inequality

The period for which data on income distribution are available for the countries of the ECAFE region is too short to permit any study of regional trends.

¹⁷ The figures for *per capita* income are taken from *Economic Bulletin for Asia and the Far East*. (United Nations publication, sales No.: E.69.II.F.12), Vol. XX, No. 3, December 1969.

¹⁸ Ojha, P. D., "A Configuration of Indian Poverty", in *Challenge of Poverty in India* (ed. A. J. Fonseca), Wikas Publications, Delhi, 1971; and in *Reserve Bank of India Bulletin*, January 1970. Other studies on the same theme include: Dandekar, V. M., and Rath, Nilkanth, "Poverty in India", *Economic and Political Weekly*, Bombay, Vol. VI, Nos. 1 and 2, 2 and 9 January 1971; Pranab Bardhan, "The so-called green revolution and agricultural labourers", *Economic and Political Weekly*, Bombay, Special Number 1970; Minhas, B. S., "Rural poverty, land redistribution and development", *Indian Economic Review*, Vol. V, New Series, 1 November 1970; and Vaidyanathan, A., "Some aspects of inequalities in living standards in rural India", paper submitted to the Seminar on Income Distribution in India, New Delhi, 1971. In the United States, the boundary line for poverty (\$3,000), recently raised, is based on an "economy plan" budget for a non-farm family of four (See *Annual Reports of the Council of Economic Advisers*, January 1964 and January 1966). Caloric consumption needed for basal metabolism is also discussed by Oshima, Harry T., *Food Consumption, Nutrition and Economic Development in Asian Countries*, *Economic Development and Cultural Change*, July 1967.

Furthermore, detailed information on factors producing more or less equality are not available for these countries. In any event, in trying to understand the level of inequality or poverty in a country, it is not enough to investigate causality in a manner reminiscent of the methodology of classical mechanics; a study of the processes and mechanisms of economic growth is a much more rewarding source of knowledge in this field. For this purpose, a detailed study of each country is required, together with one or more surveys covering a number of countries. Until such material becomes available only broad deductions can be made concerning certain obvious factors influencing the distribution of income.

Theoretically, the shape of the standard distribution should be influenced, in the main, by such factors as genetic inheritance, family background, formal education and training, age, and the hierarchic structure of organizations. However, there is one further environmental factor of great importance. There is abundant evidence to suggest that children who grow up in agricultural districts, especially on farms, are, in almost all countries, significantly handicapped in finding employment in non-farm industries. The *prima facie* plausibility of this finding is supported by the almost universal tendency for agricultural wage incomes to be lower than wages in non-agricultural employment, and by the fact that the quality and quantity of education in rural areas tend to be poorer than that in urban areas.

A great deal of statistical material supports the common sense view that farm people are generally at a disadvantage in an urban environment. In practice, since the movement of population from farm to town is common to all countries, the deficiencies of a farm upbringing, from an urban point of view, must have had an important influence on the distribution of earnings among urban employees.¹⁹

Any observed large decline in poverty must be attributed primarily to an increase in income from labour. People now tend to invest more heavily in the acquisition of skills and in education and training, the demand for which expands with economic growth. Those who can not afford to invest in this "human capital" may fall behind and stay "poor".²⁰ Urban poverty is believed to be, in a sense, an overflow of rural poverty. Because rural people in the low-income group find themselves "unemployable" in the

¹⁹ Lydall, *op. cit.*, pp. 200-210.

²⁰ The vast expenditures of the United States Government on agriculture have not been used to raise the level of skills of farm people. On the contrary, they have been used in ways that enhance the income of some classes and worsen income distribution among farm families. See Schultz, Theodore W.: "Investing in Poor People: An Economist's View", *American Economic Review*, May 1965, pp. 510-520.

urban environment as a result of their deficient education and training, they continue to be poor. The large number of "drop-outs" is also a point worth noting in this connexion. The reasons for "dropping-out" should be explored. A proper alignment of educational planning with development planning in both rural and urban areas is the only way of tackling such problems in a dynamic context. Total expenditure on education and training may not be sufficient in itself to improve productivity. A detailed programme in this respect may prove more effective.

Structure of the economy

The structure of the economy and of the population is an important aspect of the distributional problem. Incomes originating in the agricultural sector predominate in the developing countries of the ECAFE region. Moreover, the services sector includes many low-paid occupations, such as retailers, domestic servants shop assistants and itinerants. If growth signifies structural change, quantitative and qualitative, it cannot be measured in terms of changes in aggregative GDP measures and *per capita* income alone but demands a detailed understanding of the changes which occur during the period of growth and of the process and mechanics of growth.

Changes in the structure of the economy inevitably affect income distribution. The initial distribution of income, saving, wealth, education and training, and labour force between agriculture, industry, and services and within industry among the modern, semi-modern and, "traditional" categories, will, in any economy, be a "given" factor based largely on "history"; the initial position is accordingly "inherited" at a specific point in time. It is believed that there is a tendency for inequality to widen during the period of rapid growth from this initial position. For instance, large inequalities in income per head among various sectors tend to widen the gap between the incomes of the sectors in the early stages of growth. Relatively large increases in the output of low-productivity sectors may still leave their output per head below the rising national average, whereas smaller increases in the high-productivity sectors may keep them well ahead of the rest of the economy. Similarly, an increase in the services sector's share in national income need not signify improved income distribution. Thus, reliance solely on structural changes in the economy may not in itself promote more equal distribution of income.

Growth in itself does not provide a complete answer to the problem of inequality. It is believed, however, that in circumstances in which income per head has been growing at a rapid rate over a long

period, it becomes easier to institute measures which are effective in reducing inequalities. Accordingly, a period of rapid economic growth may be considered a necessary but not a sufficient condition for solving the problem of income inequality.

Though the countries of the ECAFE region are pursuing a policy of raising the rate of growth and standard of living and are implementing growth policies using planning techniques with varying degrees of intensity, achievements have not been substantial. Growth rates in GDP for developing ECAFE countries as a group were in the range of 4 to 4.4 per cent during 1950-1968. For a variety of reasons, very few countries of the region have enjoyed an uninterrupted period of sustained and stable economic growth over the past two decades. Moreover, since the annual population growth rate has been in the range of 2 to 2.5 per cent, gains in terms of GDP *per capita* have been less than 2 per cent.²¹ Moreover, qualitative changes in the economy have occurred which are not adequately reflected in the growth statistics. In fact, "development potential"²² has increased at a faster rate than income in some countries, thus making it possible for income to increase in future at higher rates than in the past. Lack of adequate data precludes any judgement on how the rates of growth, including that of "development potential", have affected income distribution in developing ECAFE countries.

During the period of rapid growth combined with structural changes, a qualitative change occurs in consumer tastes and in the labour supply, which causes the vertical and horizontal mobility of labour and resources. The situation is not that, between two terminal years, the same persons or households remain represented in the upper decile or lower decile groups nor that the same "poor" people become poorer or the same "rich" become richer when inequality (statistically) increases during the growth process. The probability is that some persons from the top deciles move down and some persons from lower deciles move up in the process. Such mobility, if rapid, can contribute to equality, although in practice this may not happen for a variety of reasons.

Mobility restrictions

In the developing ECAFE countries, for instance, the self-employed group is highly represented in the top income bracket. Non-farm entrepreneurs, too,

²¹ For details, see Part Two of this Survey.

²² See Divatia, V. V., and Bhatti, V. V.: "On Measuring the Pace of Development", *Banca Nazionale del Lavoro*, June 1969. "Development potential", based on fundamental factor inputs such as capital and skills, is estimated to have grown at an annual rate of 7 to 8 per cent in India: double the rate of growth in real national income.

are more than proportionately represented in the high-income group. Business units organized as proprietary small-scale concerns predominate in such economies. These forms of organization are believed to make for less mobility of labour. This is so because the holders of positions at the top are likely to have been appointed largely for family or other personal reasons; those from the lower groups from getting opportunities to move to the top.²³

Among the salary- and wage-earning group, mobility depends largely on education and training. If the low-income groups lack equal, or at least adequate opportunities for education and training, they may not be able to move up the income ladder. Equalization of educational and training facilities, in step with changing demands for particular types of skill, is a necessary concomitant of a policy for reducing the type of inequality which arises out of immobility based, in turn, on inadequate educational attainment. No detailed information on this aspect of the problem is available for countries of the region.

Such fragmentary information as there is indicates that, in the wholesale and retail trades, finance and the professions, scale economy in operations is insignificant in the countries of ECAFE region. Low-income-yielding occupations include unskilled domestic servants, clerks, guards, and helpers in small entertainment and recreational units, occupations which are being displaced in the industrialized countries by large enterprises using labour-saving equipment and machinery. In the Asian countries, however, such services are still largely provided on a personal basis.

In the developing ECAFE countries, the services sector also includes rich proprietors operating wholesale, finance, real estate and recreational undertakings, many of whom enjoy a monopolistic and oligopolistic position. The financing, transporting, warehousing and packaging operations involved in the entrepot trade, income from tourism, shipping and entertainment, rents from timber-producing land, and fees for professional services are all sources of large incomes in the great cities of southeast Asia. All this is deeply rooted in the history of the region.²⁴ In Thailand, for instance, gross profits per proprietor in the wholesale business are reported to be extremely large, about 10-20 times as large as those for the services sector as a whole. Similarly, annual wages per employee in restaurants, laundries, tailor's shops

and retail trade are reported to be one-tenth of those in the wholesale trade.²⁵

Small units and income equality

Small units, when they predominate in an economy, usually pay low wages. In the Philippines, for instance, small industrial units (with fewer than ten persons engaged) paid average wages about two-thirds as high as those paid by the larger establishments, the corresponding figure for Singapore being one-half and for the Republic of Korea two-thirds. Wages paid in agriculture are even lower. In the Philippines, the fixed legal minimum wage is 6 pesos per day for non-agricultural work but only 4 pesos in agriculture. In Thailand, weekly wages for male agricultural workers (January-June 1954) were roughly 20 per cent lower than those for manual workers and labourers. For Ceylon, in the Colombo district, male workers in agriculture received wages 30-40 per cent lower than those of the workers in small industries.²⁶

Thus, the lower part of the family income distribution includes families in agriculture and in non-agricultural small-scale units. Since these sectors are very large in most of the countries of the region, nearly all the families in the lower half or two thirds of the family income frequency distribution fall into these labour-intensive sectors.²⁶ Thus, development plans and programmes aimed at raising the incomes of these small-scale units would tend to equalize income distribution. In India, for instance, under all the five year plans, the growth of small-scale industries and agriculture has been assigned certain priorities, and the growth of these sectors has attracted greater attention in recent years. With the nationalization of commercial banking business, credit facilities and other banking services are increasingly being extended to these sectors.²⁷

In brief, in the developing ECAFE countries, traditional, semi-modern and modern establishments co-exist in each sector. The lowest incomes are received by those engaged in traditional establishments, in which most of the work is done by hand and in which there is less mobility. In the modern establishments, the operation of sophisticated machines requires highly-trained workers. The incomes of these workers are higher than those of semi-skilled and

²³ *Ibid.*, p. 26.

²⁴ Mobility in the countries of ECAFE region is also believed to be limited by physical and other social causes. See Oshima, Harry T., in *Malayan Economic Review*, *op. cit.*, pp. 24-26.

²⁵ See Oshima, Harry T., "Income inequality and economic growth: The post-war experience of Asian countries, *The Malayan Economic Review*, vol. XV, No. 2, October 1970, pp. 26-27.

²⁶ Oshima, Harry T., "The labour force 'Explosion' and the labour-intensive sector in Asian growth", *Economic Development and Cultural Change*, vol. 19, No. 2, January 1971, pp. 171-173.

²⁷ For details, see the *Fourth Five-Year Plan*, Government of India, New Delhi, and also the annual reports on the working of the Reserve Bank of India and the trend and progress of banking in India for the years ended 30 June 1970 and 30 June 1971.

untrained workers. Inequality arising out of these factors can be reduced only through a combination of changes in the organizational patterns of business units, the transformation of the economy, and the equalization of educational and training opportunities. This combination will, in the nature of things, be slow to produce results and its impact will be visible only in the long run. However, planners cannot ignore these requirements.

Inequality and saving

The concentration of saving in the upper income bracket intensifies inequality in the distribution of personal income. Within the low-income group, the saving of some families is offset by the dissaving of others, and thus the group as a whole has little or no net saving. The low-income family's saving capacity is, in any event, restricted by the size of its income: the income received is generally just not enough for purchasing basic daily requirements. Most saving is accordingly done by the top households, and it is therefore frequently argued that the effect of an increase in the degree of inequality is to raise saving. For this reason, some argue that a reduction in the degree of inequality, in reducing saving, will impair the growth process.

➤ Evidence is available, though not in great detail, about saving patterns. There are instances in which an increase in the degree of inequality, particularly among non-salary income-earners, has produced higher saving-income ratios. On the other hand, instances are also cited in which saving increased with a more equal distribution of income. It is, therefore, unsafe to generalize on this matter at the present time, given the inconclusive evidence.

The data for India show that the saving-income ratios for the household sector, and particularly for urban households, rose with an increase in inequality in 1955/56-1956/57 over the earlier period 1953/54-1954/55. Among the high-income recipients, the share of the non-salary-earner group increased substantially in the second period over the first period.²⁸ In recent years, because of the increase in farm incomes, saving in the farm sector may have increased. Ratios of net saving to disposable income in the urban sector were estimated to be -8.6 (low

income group), 12.3 (middle) and 44.5 (top income group).²⁹

By 1959, Japanese farm family incomes had risen to equal those of non-farm families. During the 1920s and 1930s, however, income per farm person engaged was only about one-half of the national average, and, during 1926/27, about two-thirds of the farm families surveyed were reported to have dissaving. By 1963, after land reform and the rapid rise in agricultural productivity, nearly all brackets of farm families were reported to have positive savings. From this analysis,³⁰ it was concluded that the more equal distribution of family incomes in post-war Japan, compared with pre-war decades, probably contributed to the increase in personal savings by eliminating dissavings in the lower income groups.

For the Philippines, the 1961 data show that 75 per cent of families were in the lower income brackets, which dissaved, and that their dissaving absorbed 94 per cent of the gross (or positive) savings of this group. The Gini coefficients were calculated to be 0.49 for 1956, 0.52 for 1961 and 0.51 for 1965. Farm family incomes are estimated to be only one-half of those of non-farm families. The previously mentioned ECAFE secretariat study of the distribution of income in the Philippines indicated an increase in the degree of inequality from 1956 to 1961 and 1965 and an increase in the marginal propensity to consume in the highest income bracket (10,000 pesos and above) from 0.397 in 1961 to 0.770 in 1965. Moreover, except for the highest income bracket in 1961, the marginal propensity to consume for different income classes revealed no regular tendency to decrease as the income class rose.

For Ceylon, the Gini coefficient works out at 0.42 (1953) and 0.45 (1963), with the household as income-receiving unit. The estimated proportion of families in the dissaving brackets was 76 per cent; the amount of dissaving exceeded that of gross (or positive) saving of those brackets in 1963. Farm family incomes were estimated at two-thirds of those in non-agricultural sector.³¹

In a tentative study³² of the personal income distribution and personal savings in Pakistan in 1963/64, it was found that rural households saved 10.9 per cent of their gross personal income, as

²⁸ Ojha, P. D., and Bhatt, V. V., "Distribution of income in the Indian economy: 1953/54 to 1956/57", *Reserve Bank of India Bulletin*, September 1962; and "Some aspects of income distribution in India", *Bulletin of Oxford University Institute of Economics and Statistics*, August 1964.

²⁹ Oshima, Harry T., in *Economic Development and Cultural Change*, *op. cit.*

³⁰ Oshima, Harry T., *ibid.*, p. 174.

³² For further details and limitations of this study, see A. Bergan, "Personal income distribution and personal saving in Pakistan: 1963/64", *The Pakistan Development Review*, vol. VII, pp. 160-212.

²⁸ 'Saving' in the Indian estimates represents net saving and excludes durables.

compared with the 7.4 per cent for urban households, although inequality in income distribution was higher in the urban than in the rural sector. It was also found that rural households in each income group saved a higher proportion of their income than comparable households in urban areas and that urban households having a monthly income under Rs 100 showed negative savings whereas rural households showed positive savings, even at this low income level.

The degree of inequality was found to be lower in India than in some of the developed countries, probably because India started the process of economic development by abolishing the big feudal and landed interests in the early 1950s; the big landlord class had been eliminated in India by 1953. The top urban industrial class in terms of income was not as large as the class of large landowners had been before 1953.⁹³ The "green revolution", whose impact has been felt since 1965, has increased farm incomes and hence farmers' saving capacity. Ceylon, India, Pakistan and the Philippines have not fully implemented their land reform policies, indicating that further gains are possible along this line.

➔ No positive conclusions can be reached on the subject of inequality and saving. In any event, the data limitations are such that the statistics can only be illustrative. It is conceivable, however, that less inequality may, in certain circumstances, not reduce personal saving, an important conclusion with respect to the effort to harmonize growth and social welfare directives. Since aggregate saving is always net (i.e., the difference between positive saving of high-income groups and negative or nil saving of low-income groups), an improvement in the saving capacity of large numbers in the low-income group may in the aggregate increase total net saving.

Since saving is essential for investment, and since it occurs predominantly in the top income groups, it is believed that inequality is essential for growth. Nevertheless, Keynes (an advocate of moderate equalization) has shown that during unemployment caused by demand deficiency, excessive thrift, and hence the inequality that causes it, will reduce the output (and thus the growth rate). The difference between the saving-income ratios of different income groups is much smaller than was once thought. Moreover, saving levels are controlled by other, and more important, determinants than income differences. Important routes to saving by the less wealthy have become available recently — postal saving programmes, building societies, life insurance, superannuation

schemes, provident fund contributions. Public sector saving and investments is not the only path to growth in the developing ECAFE countries.

And investment, in the traditional sense of the term, is not the only path to growth. The conventional conception of investment relates to fixed investment and business inventory, i.e., changes in the value of the stock of physical capital goods such as merchandise, machinery, equipment and roads. For growth, investment in human capital, organizations and institutions is now believed to be an equally important factor. The traditional division of income into consumption and saving thus becomes less meaningful in the context of growth. Certain types of consumption expenditure, such as spending to improve health and medical conditions or caloric and nutritional values of food, or outlays which raise efficiency and productivity, may be as essential as fixed capital in promoting growth. Any expenditure which can be shown to result in a satisfactory rate of return (cost-benefit ratio), or which will cause income to increase in future by more than the discounted cost, should be considered relevant to growth.

Saving propensities tend to be low in the very countries which have highly unequal income distributions. Savings are affected by absolute levels of incomes, of course, but also, in the developing countries, by the top income group's high propensity to consume in order to maintain its accustomed standard of living. This group's propensity to spend on imported luxury and semi-luxury goods, domestic service, travel and entertainment is reported to be high. The curtailment of such consumption is desirable for growth. Some incentives for saving are undoubtedly essential, and they may be financial or non-financial. To what extent financial incentives promote saving and whether non-financial reward may be equally important are unsettled issues.

Government sector saving

The most important factor, however, is the function of the State as an employer and producer. Services such as education, medical and health facilities, and housing, which in earlier times would have been financed out of personal income (saving), are now largely financed by government expenditure. Government saving is likewise an important factor in financing investment projects.

Thus both private saving and the saving of the government sector are relevant to investment. When the volume of savings and investment is decided primarily by the Government, as happens under planned programmes of economic development, it ceases to be a possible side-effect of any chosen distribution of income.

⁹³ Ojha, P. D., and Bhatt, V. V., "Pattern of income distribution in an underdeveloped economy: A case study of India", *American Economic Review*, September 1964 and December 1965.

Reduction of inequality and growth incentives

When inequality in the distribution of income is attributable to inherited income-producing wealth, usually in such forms as land or real estate, a reduction in wealth inequality is generally accepted as desirable since it will not directly affect incentives to save and invest. The reduction can be brought about by such measures as a ceiling on land and urban property ownership, wealth tax, estate duty and gifts tax, all or some of which are being tried out in various ECAFE countries. The redistributive effect of these measures will naturally become noticeable only gradually over the years.

Direct taxes can easily be made progressive. However, in developing countries which have a substantial proportion of small-scale producing units, largely unorganized, and a large proportion of income originating in agriculture (which are always administratively difficult to tax), great opportunities for evasion exist. These two sectors are often declared to be preferred under the national economic policy, and concessions, including fiscal concessions, are given to them with a view to promoting growth and adjusting the income distribution. The disincentive effects, if any, of progressive direct taxes on saving are therefore likely to be small, simply because they are not widely collected. For the same reasons, the effectiveness of progressive direct taxes on personal income distribution is likely to be limited. Even in the United States, where income tax levied on individuals accounts for nearly 10 per cent of total personal income, the disposable personal income concentration ratio is 0.32, as against 0.35 for pre-tax income, in other words, a reduction of only three percentage points. Where tax collections on individual incomes are around 2 to 3 per cent of GNP, as in India, the concentration ratio works out at 0.33 for disposable personal income, as compared with 0.34 for personal income, i.e., a reduction of only one percentage point (1953/54 to 1965/66). On the whole, the redistributive effect of direct progressive taxes is limited under the present condition in the developing ECAFE countries.

In the past, the industrialized countries of today had inequality of saving and income and experienced growth. The developing countries of our time need not, and in fact do not, follow the same growth path. Moreover, the "countervailing power" of political consciousness, the trade union movement and adult franchise followed economic development in the developed countries, whereas it has preceded economic development in today's developing countries. Again, the State has come to be a powerful instrument for promoting growth and investing in "human capital" in the developing countries, and measures to

improve the efficiency of organizations and institutions are initiated by it. The saving of the top households is therefore no longer the sole determinant of growth. In fact, it is possible that reduction in inequality and the resultant improvements in the incomes accruing to the mass of the people (those in the lower and middle deciles) may increase total personal saving. Once the "basic" needs of people have been satisfied in the poor countries, in which great inequality prevails and which are the very countries with low saving, saving may well rise.³⁴ Since the propensity to consume in the high income brackets is also believed to be high, a reduction in consumption by means of reduced inequality should be considered desirable for growth and not harmful, as the conventional approach argues. The greater inequality prevailing in the developing countries imposes an unduly low limit on growth and industrialization through import substitution so long as the types of industry contemplated cater primarily for the numerically small higher income groups. On the other hand, import substitution applied to agricultural products and the simple consumer goods required by poorer people has an almost limitless potential for achieving growth, employment and saving in the coming decade or so. "There is a danger in simple analogies; . . . what we need . . . is a clear perception of past trends and of conditions under which they occurred, as well as knowledge of the conditions that characterize underdeveloped countries today".³⁵

D. Conclusion

The initial motivation for an interest in the study of income distribution by size is usually a vague sense of social justice, but such studies also have a strictly economic justification. The basic problem of the developing countries today is not merely the existence of inequality in distribution of income *per se*, but the absolute levels of poverty of the majority of people. The measurement of income distribution demonstrates at best the position of a household in the economic hierarchy, not the absolute level of poverty of the people.

Much of the inequality attributable to unearned income is hereditary. The redistribution of wealth is therefore desirable as a means of equalizing income and increasing growth. However, while fiscal and other measures may prove effective for this purpose, reliance on the Government's tax and expenditure

³⁴ See Oshima, Harry T., in *Economic Development and Cultural Change*, January 1971, and in *The Malayan Economic Review*, *op. cit.*, and Lipton, Michael, *Assessing Economic Performance*, Staples Press, London, 1968.

³⁵ Kuznets, Simon, "Economic growth and income inequality", *American Economic Review*, March 1955, pp. 25-26.

policies alone may not produce the total desired redistributive impact.

Statistical data are always a by-product of needs and practices. Accordingly, once the attack on poverty or the reduction of income inequality comes to occupy a high priority among national economic objectives, relevant data will become more readily available. The data available at present do not enable the "poor" in the developing countries of the ECAFE region to be identified. This task of identifying the "poor" needs to be performed for each region and sector of every country before effective policy instruments can be implemented.

Since neither the money income of a given year nor the average of a number of years is an adequate measure of welfare, a standard has to be set in terms of a normal or reasonable "balanced diet" budget for a family defined in an appropriate way. Guidelines need to be set for gradually raising income to a level permitting such "balanced diet" family consumption. The fact of unequal income distribution is not the sole disturbing factor; absence of a reasonable "balanced diet" for each family causes just as much social tension. That is, absolute as well as relative standards must be developed.

Families who suffer from unemployment and/or low income status for such specific reasons as retirement, physical handicaps, lack of education, or ethnic or regional bias should be segregated for special study and action from others in this category. Those who are "unemployable" for physical or other reasons need separate treatment through specific welfare measures. When the causes of poverty are clearly discernible (inadequate and unequal educational and training facilities, lack of mobility, institutional and organizational barriers), measures to meet these deficiencies will have to be devised. The quantitative expansion of educational and training facilities is important; equally important is their quality. A proper alignment of educational and training programmes with development planning is a vital need.

Each country of the ECAFE region has its peculiar socio-economic structure, and full national studies of the problem are therefore required. Political commitments, for example, are not identical: in India the Constitution enjoins the Government to reduce the concentration of income and wealth, and this is one of the stated priority objectives of the five-year plans. In some other countries, specific attention is paid to ethnic and regional distribution skews.

In the final analysis, a new regular sources of income must be provided by creating job opportunities suited to the talents and skills of the people, and this demands rapid growth of the economy. Growth

alone, however, will not be a sufficient condition in itself to generate employment and raise levels of living, although it will make the task easier and more manageable; other convergent measures will be needed. Educational opportunities are generally not equally distributed; training and experience mean heavy "investment" and hence may not be accessible to all; similarly, credit and other financial facilities may not be easily available. Specific measures will therefore be needed to break down the barriers facing different categories of people.

In most countries of the region, incomes originating in the agricultural sector are far lower than those in the non-agricultural sector. The modern industrial sector is relatively small, as are the proportion of the total labour force it employs and the position of national income originating in it. The bulk of the labour force is dependent on agriculture, in which product per head is traditionally lower than in other sectors. A rise in the productivity of the agricultural sector is accordingly essential for improving the lot of the people dependent on it. The "green revolution" (the application of modern methods of farming, the use of fertilizers and pesticides, a better combination of land and labour) will improve yield per hectare. Since, in the initial phase of the "green revolution", all inputs are unequally distributed (land, access to credit facilities, fertilizers, equipment, information) there may be a tendency towards greater inequality in the distribution of the gains from rising productivity. As multiple-cropping patterns develop, however, and as the necessary measures are taken to spread the benefits wider by disseminating information and ensuring the availability of credit, fertilizer and pesticides to all farmers, the gains will become more equally distributed. This may not happen automatically, and timely supporting, policy measures, including land reform, will have to be implemented. Certain associated measures are probably inescapable. For instance, people who lose their agricultural occupations in the wake of the technological revolution will need to be trained before being absorbed in newly-emerged activities, such as the processing of agricultural products, marketing and allied work.

At the present stage of industrialization in the developing countries of the region, the capacity of the modern industrial sector (adjusting for "backward" effects) to absorb part of the labour force, which is growing at 2 to 3 per cent a year, is extremely limited and will probably remain so, at least for the next 10 to 20 years. The sector is still small, and it employs a very small portion of the total labour force. Even if it were to grow twice as fast as it has grown in the past decade, it would be unlikely to make any substantial impact on the employment situation for quite some time.

However, the industrial sector also includes, in most instances, intermediate and traditional sub-sectors. Technological change will cause output per unit of labour or capital employed to rise and labour employed per unit of capital or output to fall. Concentration on productivity alone will therefore mean relatively small, if any, increases in employment. Industrialization and modernization within the industrial sector are undoubtedly important policy factors in economic growth, but until such a time as industrialization becomes widespread a different approach to the employment problem, one which will improve income distribution and eradicate poverty, will be justified. The vast small-scale industrial subsector and suitable non-farm activities in the rural areas will need special attention; productivity in these areas will have to be improved in order to raise the levels of living of the vast majority of the people.³⁶

Sustained and marked increases in *per capita* income are a consistent feature of economic growth. It follows that, barring factors to the contrary, the incomes of a large proportion of families will rise more in a country with sustained economic growth than in a stagnant or slowly-growing economy; in other words, absolute upward income mobility is a direct function of economic growth. However, since rapid growth is neither automatic nor universally shared, deliberate government intervention may be necessary at strategic points to ensure that the rise in incomes is equally shared by the entire nation and that income mobility occurs.

In the process of growth, some factors work to produce greater equality and others in the opposite direction. The first two of the following forces are believed to emerge early in the process of industrialization and the third appears much later:³⁷

(a) Narrowing of product per worker in major industry sectors occurs: this should narrow inequality in the long run;

(b) Movement of workers from self-employment to the category of true employees: this means larger inequality. Institutionally imposed limitations bear more heavily on salaries than on other incomes. A

rise in the proportion of all salaried employees will tend to reduce inequality. A decline in the proportion of wage-earners among all employees means a low weight for the low-income/unskilled labour components of the total;

(c) The share of property income in total household income decline: this leads to more equality.

It may be of interest to note that the share of labour in personal income in some countries of the West remains more stable when the analysis is confined to the business sector than when it is related to total income. Total income has grown more than income originating in the business sector mainly because of the growth of the government sector, and since, in the government sector, wage and salary dispersion is believed to be smaller than in the business sector, this development leads to greater equality. On the other hand, the form in which property income is distributed changes in the long run. For instance, compensation in kind for executives (liberal entertainment allowances, generous expense accounts, stock option provisions) may be treated as business costs. Under a progressive income tax system, it is thought, the tendency to give such incomes supplements in kind to top executives is strengthened, thus increasing inequality. Furthermore, where there is a tradition that the filling of top positions in certain professions is influenced by family or personal connexions or by similar factors, the Government will need to introduce specific measures to remove such barriers to the vertical mobility of labour.³⁸

In view of the characteristics of the growth process just described and of the probable incidence of such factors as the substantial tax and other concessions given to encourage private investment in new ventures, it is a plausible assumption that the early phases of the growth process are characterized by a balance of counteracting forces which may temporarily widen inequality in the size distribution of total income, because of the rapid growth of the non-agricultural sector and the wider inequality within it.³⁹ This need not necessarily be the experience of every country which is now industrializing, however. Circumstances vary, and the chosen growth paths of different nations are not identical. Again, political and institutional settings vary, and the degree of

³⁶ This subject is further treated in the preceding chapter of this *Survey*. See also Ojha, P. D., "Configuration of Indian poverty", *Reserve Bank of India Bulletin*, January 1970; Myrdal, Gunnar, *Asian Drama: An Inquiry into the Poverty of Nations*, Allen Lane The Penguin Press and Penguin Books, 1968, chapters 26 and 27; Atkinson, A. D., "Policies for poverty", *Lloyds Bank Review*, April 1971, pp. 17-28; McCall, John J., "An Analysis of poverty: Some preliminary findings", *The Journal of Business*, April 1971, pp. 125-149; and Oshima, Harry T., "Accelerated growth: Japan's experience", *Economic Development and Cultural Change*, Vol. 19, No. 1, October 1970, pp. 111-127 (review article).

³⁷ Kuznets, Simon, *Modern Economic Growth: Rate, Structure and Spread*, Yale University Press, 1966, p. 205.

³⁸ See Lipton, *op. cit.*, p. 94. Even in the United Kingdom, for instance, personal advancement depends more on hereditary distinctions than in comparable advanced economies. The public school system, under which great educational advantages are given to children of rich parents, is peculiar to the United Kingdom and is linked to what is, in effect, a hereditary allocation of the best job opportunities. For example, of the Board of Governors of the Bank of England in 1965, five members were from Eton, seven from other public schools and only four from grammar schools.

³⁹ Kuznets, Simon, *op. cit.*, pp. 215-217.

emphasis on policy goals is a matter of national choice.

It is a well-known principle of the modern theory of economic policy, first put forward by Tinbergen, that in order to secure a stated number of objectives the Government needs to operate an equal number of policy instruments: it is only in exceptional circumstances that a single instrument can secure the attainment of more than one "target" simultaneously.⁴⁰ The failure of most Governments to pursue policies which are consistent in their declared plan objectives may thus be attributed primarily to poor orchestration of instruments, i.e. to not using

enough separate policy instruments to secure the simultaneous attainment of all objectives.⁴¹

In any event, whatever limitations may exist in development in policy implementation, a developing country must treat absolute poverty as amenable to solution. The solution will probably require at a minimum the provision of additional income for households below the "poverty line" through increased regular employment opportunities and improved educational and training facilities.

⁴¹ Kaldor, N., "Conflicts in national economic objective", *Economic Journal*, March 1971, p. 4:

"On a more realistic plan, I think one must recognize that the limits on the degrees of freedom of government policy were set by political, social and ideological constraints which inhibited action in certain fields; the intellectual failure to recognize the need for them was a symptom rather than the cause of the inhibition."

⁴⁰ Tinbergen, J., *On the Theory of Economic Policy*, Amsterdam, 1952, chapters IV and V; also Meade, J. E., *The Balance of Payments, Mathematical Supplement*, Oxford, 1951, pp. 28-29.

ECONOMIC SURVEY OF ASIA AND THE FAR EAST, 1971

PART TWO

CURRENT ECONOMIC DEVELOPMENTS

Chapter I

RECENT ECONOMIC DEVELOPMENT AND EMERGING POLICY ISSUES IN THE ECAFE REGION, 1970/71¹

This chapter commences with a brief review of recent economic developments in the world economy. It then surveys developments in the developed and developing countries of the ECAFE region in 1970 and early 1971 and assesses the prospects for continued economic growth in the region in 1972. A discussion of some of the major emerging policy issues, which will affect economic progress during the Second Development Decade, is also given in Part One.

A. The international situation, 1970/71

Because of their greater economic weight, the policies and performances of the main industrial countries significantly influence the tempo of economic growth in other countries. The most notable developments in the world economy were a slowing down in the growth of world output at continuing high levels of unemployment, a continued inflation in industrial and non-industrial countries, the spillover of domestic price increases into international trade, and a generally adverse shift in the terms of trade of the developing countries.

Output and prices

Table II-1-1 indicates that total world output grew at only 3.0 per cent in real terms in 1970, which was considerably below the 5.0 per cent per annum growth rate recorded in the 1960s. The world performance, however, is strongly influenced by economic activity in the United States, which actually declined in real terms in 1970. Excluding the United States, developed and developing countries, considered as separate groups, each attained an average GNP growth rate of 6.0 per cent, which was considerably better than their individual group performances in the 1960s, and, for the developing countries, in line with the target set for the Second Development Decade.

In the USSR, the performance of the economy in the first ten months of 1971 suggests that the targets set for 1971 in the ninth five-year plan will be achieved. Output in the industrial sector will be in excess of the target and the performance in the agricultural sector is generally satisfactory. The planned growth in real incomes for the year will be attained. In 1972, national income is scheduled to grow by 6.2 per cent, industrial output by 6.9 per cent and real *per capita* incomes by 5.2 per cent.

Inflation in nearly all major industrial nations remained strong despite the anti-inflationary policies adopted in 1970. As measured by the GNP deflator, inflation in industrial countries proceeded at nearly 6.0 per cent in 1970, which was in excess of the rate of inflation in the past decade. In the developing economies, increases in consumer price indices averaged around 9.0 per cent, which was considerably higher than in 1969.

Inflation in the industrial countries in 1970 continued to be dominated by cost-push factors and failed to respond to the tighter monetary and fiscal policies of late 1969 and early 1970, even though these policies resulted in relatively high levels of unemployment. In the developing economies as a whole, while inflation was generally the result of excess demand conditions, some of the rise in prices was inevitably brought about by the rising cost of imports from the industrial countries.

The likely trends in output and prices in 1972 have been made more difficult to predict as a result of the recent exchange rate alterations. Following the check to the rate of increases in output in 1970, most Governments in industrial countries turned to expansionary policies. As a result, the OECD Economic Outlook of July 1971 was of the opinion that the prospects for mid-1972 were for fairly rapid expansion of output in North America, for somewhat below-average growth in other major industrial countries and for rather slow expansion in smaller industrial countries. As compared with 1970, the average rate of growth in real GNP in OECD countries (including the United States) should increase from 2.6 per cent in 1970 to 3.75 per cent in 1971 and to 5.75 per cent for the first quarter of 1972. Only moderate success was expected to result from efforts to reduce inflation. In the first two quarters of 1971,

¹ In some cases the data provided in this chapter are not consistent with data given in the individual country chapters of this *Survey*. In the few instances concerned, these inconsistencies arise because the preparation of this chapter has relied mostly on international sources of statistical information whereas the country chapters have normally derived their data from national sources.

Table II-1-1. GROWTH OF WORLD TRADE, 1960-1969
(in percentages)

		Weight ^a	Trend	Change from preceding year		
			1960-1970 ^b	1968	1969	1970
<i>Exports</i>						
World ^c	Value	100.0	9.5	12.0	14.5	14.5
	Volume		8.0	12.5	11.0	8.5
United States and Canada	Value	21.5	8.5	12.5	9.5	15.0
	Volume		6.5	10.0	5.5	9.0
Japan	Value	6.6	17.0	24.0	23.5	21.0
	Volume		16.5	24.0	18.0	14.5
EEC countries	Value	31.1	11.5	14.5	18.5	16.5
	Volume		10.0	16.0	13.5	10.0
EFTA countries ^d	Value	14.5	8.0	8.0	15.5	13.0
	Volume		6.5	12.0	12.0	5.5
Primary producing countries: more developed areas	Value	6.5	9.0	4.5	15.5	12.5
	Volume		8.0	9.5	12.5	9.5
Primary producing countries: developing areas ^e	Value	19.8	7.0	9.5	12.5	10.0
	Volume		6.0	10.5	8.0	7.0
<i>GNP in volume</i>						
World ^e		100.0	5.0	5.5	5.5	3.0
Industrial and more developed primary producing countries		85.3	5.0	5.5	5.0	2.5
Excluding United States		43.6	5.5	6.5	7.0	6.0
Developing countries (including oil producers)		14.7	5.5	6.0	6.5	6.0

Source: IMF, *Annual Report*, 1971.

^a Based on trade or gross national product in 1969.

^b Compound annual rate of change.

^c All countries except the CMEA countries, the People's Republic of China, etc.

^d Excluding Portugal, Finland and Iceland.

^e Figures for developing primary producing countries in 1970 are partly estimated.

the increase in the GNP deflators of the seven largest OECD economies was only down by half a percentage point as compared with the first two quarters of 1970.

Trade

The international development of inflationary forces is evident in the statistics on world trade. Contrary to the previous marked stability of the prices of internationally traded goods, there was an increase in such prices in 1969 and an even sharper increase in 1970. Of the 15 per cent expansion in the value of world trade in 1970, some 6 per cent was due to rising prices. However, while in volume terms the expansion of world trade was less in 1970 than

in the two preceding years, it was still above the average for the First United Nations Development Decade. Current indications suggest that this decrease in the rate of growth in the value and volume of world trade has continued in 1971.

The rise in prices of internationally traded goods has occurred mainly in manufactures, and, as a result, the terms of trade of the developing economies have shifted in an adverse direction. This has reduced the purchasing power of their quite substantial increase in export earnings and exacerbated problems of import requirements and debt servicing commitments and development generally. In real terms the value of export earnings of the developing countries increased by 5.0 per cent in 1970, which was well below the exceptional increases of 10.0 per

cent in 1968 and 1969. With the exception of oil-producing countries, the outlook for the prices of primary products has not improved in 1971. Inflation in the industrial countries, however, is continuing to affect adversely the international prices of manufacturing commodities. The exchange rate appreciations which have taken place in some of the major industrial countries will further increase this negative terms of trade effect.

After having pursued disinflationary policies through 1969 to 1970, the United States and Japan both adopted expansionary policies to come to grips with growing unemployment and/or unused productive capacity. In the United States, measures adopted to correct the balance of payments situation included the floating of the exchange rate, which triggered off a number of exchange rate reactions elsewhere, and the introduction of additional quotas, particularly for man-made fibre textiles. All of these measures, including the recent agreed realignment of exchange rates, have directly affected the developing countries and are discussed in chapter II.

B. Economic development in ECAFE developing countries, 1970/71

Gross national product

While there were exceptions, the developing countries of the region, when considered as a whole,

recorded impressive increases in the level of real gross national product in 1970. From preliminary evidence available, it is obvious that these increases continued in 1971.

Rates of growth of GNP for a number of developing economies in the ECAFE region are given in table II-1-2. Of the ten countries listed in the table, the performance of six exceeded the 6.0 per cent growth target of the Second Development Decade. In only one instance, however, was the growth rate of 1969 surpassed. Among other factors, this reflects the influence of the slowdown in the growth of world trade in 1970. The four countries which did not achieve the 6.0 per cent target attained growth rates which varied from 4.0 to 5.2 per cent per annum. Subregional performances show that the developing countries of southeast Asia and the Far East, with an average growth rate per annum of 7.3 per cent, did much better than their counterparts in south Asia.

While estimates for 1971 are tentative and incomplete, satisfactory growth rates are indicated for most countries in the table. The major concern is that India, Ceylon and Pakistan appear likely to record growth rates below the targeted United Nations figure. Among other things, this is a result of these countries experiencing or having recently experienced unforeseen circumstances. Of the countries not listed in the table, the war-distressed economies of southeast

Table II-1-2. SELECTED LESS DEVELOPED COUNTRIES IN THE ECAFE REGION:
GROWTH RATES OF GNP AT CONSTANT PRICES, 1960-1971

	GNP 1965 (billion US\$)	Annual compound rates (per cent)			Changes from previous year (per cent)			
		1960-70	1960-65	1965-70	1968	1969 ^a	1970 ^a	1971 ^b
Korea, Republic of	3.0	9.3	6.5	12.1	13.3	15.9	9.7	13.9
Philippines ^c	7.8	5.7	7.3	5.9	6.2	6.7	5.4	6.5
Thailand	3.6	8.1	5.6	8.8	9.1	9.6	6.0	6.1
Malaysia	2.9	6.3	5.8	6.9	4.9	8.0	6.1	5.0
Indonesia	8.9	3.3	2.0	4.7	6.6	6.5	6.3	6.9
India ^d	50.2	3.8	3.3	4.4	3.1	5.3	5.3	4.8
Pakistan ^c	11.1	5.6	5.9	5.2	3.8	5.3	6.6	1.4
Ceylon	1.7	4.7	3.8	5.6	6.3	6.5	4.3	n.a.
Iran ^d	6.2	7.9	6.7	9.2	7.9	11.4	10.3	10.3

Source: IMF, *Annual Report*, 1971, p. 130.

^a Derived from national official publications.

^b Estimates from national official publications.

^c Year ending 31 March.

^d Year ending 20 March.

Asia have understandably failed to register significant economic performances, and the land-locked countries of Nepal and Afghanistan continue to be plagued by problems peculiar to their geographic and climatic position. The export-oriented economies of Singapore and Hong Kong experienced satisfactory growth rates in relation to previous performances. Finally, it appears that most of the newly emerging economies of the southwest Pacific are experiencing modest if as yet unsatisfactory growth rates in living standards.

Agricultural and industrial output

Output in manufacturing and agriculture is given for selected developing economies in table II-1-3. In agriculture, the performance is a mixed one, with the showing of individual countries being affected by the spread of the "green revolution" and by climatic factors. In only five of the ten countries listed was the growth rate in agricultural output greater than in the 1960s. Continuing drought severely cut agricultural production in Afghanistan, and climatic factors adversely affected agricultural production in the Philippines. However, agricultural output in India responded to favourable climatic conditions. It is significant, however, that India, Pakistan and Indonesia all recorded growth rates in their agricultural sectors which were better than those averaged in the First Development Decade.

Table II-1-4 gives information about the rate of growth in agricultural output on a commodity basis in the ECAFE region. The relatively low rate of increase in the production of cereals has resulted from adverse climatic factors including drought. The absolute output of pulses also declined in 1970/71.

Because nearly 50 per cent of the work force is employed in agriculture, the successful extension of the "green revolution" is extremely important in the ECAFE region. If it is to become a continuing dynamic force in the region, a number of urgent problems must be resolved. First, on the technical side it is evident that, for the new seed varieties to realize their full potential, adequate irrigation and fertilizer facilities are necessary. In this respect, few, if any, of the developing countries of the region have provided adequate water distribution facilities; nor are they using fertilizers in optimal amounts. Increased research efforts into rice varieties which are suitable for dry farming are urgently needed, and much greater attention needs be paid to the development of new seed varieties for other crops. Increased attention also needs to be given to the securing of a system which will efficiently distribute the inputs and market the outputs of the agricultural sectors. A more comprehensive distribution of credit facilities is urgently required.

Table II-1-3. SELECTED DEVELOPING COUNTRIES IN THE ECAFE REGION:
ANNUAL GROWTH RATES IN AGRICULTURE AND MANUFACTURING

(in percentages)

	Agriculture				Manufacturing			
	1960-1968	1968	1969	1970	1960-1968	1968	1969	1970
Afghanistan	1.5	3.0	2.9	-10.0	n.a.	n.a.	15.0	14.0
Ceylon	1.5	3.4	-0.7	3.6	13.5	14.3	n.a.	5.9
India	1.7	4.6	3.7	7.1	5.1	5.5	7.0	4.2
Indonesia	1.7	8.5	0.7	4.0	2.8	2.0	n.a.	15.0
Iran ^a	4.6 ^b	7.3	-1.1	3.0	11.3 ^c	n.a.	10.0	13.0
Korea, Republic of	4.3	-0.6	14.2	2.0	15.9	34.7	21.8	16.7
Malaysia, West	5.0	10.4	11.7	3.5	11.0 ^b	n.a.	10.0	5.0
Pakistan	3.6	5.5	5.2	6.8	8.3 ^d	7.6 ^d	10.6 ^d	7.7 ^d
Philippines	2.3	0.7	10.1	4.6	4.7	9.3	3.5	5.9
Thailand	5.3	4.8	9.7	4.0	10.8	10.1	10.6	10.5

Sources: Various official publications; individual country reports included in this Survey; for agriculture data: 1960-1968, 1968 and 1969, FAO, Record Sheets, December 1971.

^a Year ending 20 March.

^b 1960-1966.

^c 1964-1968.

^d Year ending 30 June.

Table II-1.4. ECAFE COUNTRIES: MAIN AGRICULTURAL PRODUCTION 1969-1971
AND ITS RATE OF GROWTH 1959-1961/1969-1971

(Units: 1,000 metric tons)

Items	Production			Changes		Average production		Annual rate of growth
	1969	1970	1971	1969-1970	1970-1971	1959-1961	1969-1971	1959-1961/ 1969-1971
				Per cent				Per cent
All cereals	221,548	232,995	235,519	5.16	1.08	170,731	230,020	3.0
All pulses	12,210	13,404	13,030	9.77	-2.80	14,041	12,881	-0.9
Root crops ^a	38,946	38,135	39,014	-2.09	2.30	29,749	38,698	2.7
Oilseeds ^b	13,863	15,491	16,076	11.71	3.77	11,821	15,143	2.5
Jute and kenaf	2,993	2,890	2,794	-3.45	-3.33	2,453	2,892	1.7
Cotton lint	1,840	1,736	1,901	-5.66	9.50	1,341	1,825	3.1
Rubber	2,670	2,695	2,872	0.93	6.56	1,871	2,746	3.9
Sugar ^c	19,100	20,227	19,997	5.89	-1.14	8,168	19,775 ^d	9.2
Beef and veal ^e	1,198	1,220	1,245	1.83	2.04	994	1,221	2.1
Mutton and lamb ^e . . .	836	840	850	0.47	1.19	757	842	1.1
Pork ^e	1,188	1,239	1,256	4.29	1.37	838	1,227	3.9
Milk	38,813	39,481	40,137	1.72	1.66	34,307	39,477	1.4
Copra	2,678	2,749	3,114	2.65	13.27	25,849	28,472	1.0
Palmoil	541	646	762	19.41	17.96	228	649	11.0

Source: Food and Agriculture Organization of the United Nations, computer record sheets (December 1971).

^a Potatoes, sweet potatoes, yam and cassava.

^b Sesame seed, cotton seed, soybeans, groundnuts, linseed, rapeseed and castor beans.

^c Non-centrifugal sugar and centrifugal sugar (beet and cane).

^d 1968-1970, split crop year.

^e 1971 production is only January-November.

Secondly, there is a need to allocate resources in agriculture more efficiently. Most countries which have successfully introduced the "green revolution" have emphasized not only new seed varieties, fertilizers and irrigation facilities, but have unfortunately also applied excessive price support schemes to rice farmers. Such schemes have often led to the inefficient allocation of resources as between the farming of rice and other crops and as between the development of the agricultural and other sectors of the economy concerned. Other serious distortionary effects are created by the tendency of many countries to price credit and capital equipment too cheaply and thereby promote capital-intensive farming techniques in labour-abundant countries.

Finally, close attention needs to be paid to the income distribution effects of the "green revolution". So far, it is the less poor farmer who has access to capital who has benefited most. In so far as he benefits most because his farm is of optimal size, it would be unwise to interfere directly to fulfil income distribution objectives. In many cases, however, the rich farmer benefits because public facilities are more readily available to him, because of the unwillingness

to tackle land reform, because the artificially low price of capital equipment discourages labour-intensive farming techniques and because the banking system in rural areas is often inefficient.

Although estimates of industrial output for ECAFE developing countries in 1970 and 1971 are not yet to hand, enough information is available to reach some tentative conclusions about activity in this sector in the last two years. Of the countries listed in table II-1.3, 80 per cent attained or nearly attained the average rate of increase in manufacturing output achieved in the 1960s. The performance was particularly impressive in Indonesia, the Republic of Korea and Iran. Individual achievements were strongly influenced by world trade developments where the manufacturing sectors were export-oriented, as in Hong Kong, Singapore and the Republic of Korea, and by balance of payments considerations where industrial output was closely linked to the availability of imported raw materials, semi-processed products and capital equipment. In other instances, as in the case of India, it was the low level of investment activity which was the cause of an unsatisfactory level of output.

From recent developments it is possible to reach some tentative conclusions about the nature of industrial development in the region. First, it is becoming evident that the industrial structures of many countries, such as the Republic of Korea, are in need of change. In such countries, the possibilities for further import-substitution in the production of light consumer goods are limited, and, to the extent that further import-substitution is economical, they must now emphasize the development of industries producing intermediate products and capital equipment. At the same time, to secure greater economies of scale, the smaller countries in particular need become more export-oriented. In the case of exports, an efficient industry is an automatic requirement, but it is also necessary that, in changing the nature of the import-substitution process, countries should encourage only potentially efficient industries. Otherwise, export development could be seriously impaired by an unnecessary rise in the domestic cost structure and economic development would be retarded.

Secondly, in the smaller developing countries, the development of key industries, such as petro-chemicals (including fertilizers), basic materials (iron and steel, aluminium, etc.), shipbuilding, and machinery and equipment, based on a single country's market, could encounter difficulties and lead to the uneconomical use of scarce resources. Intraregional complementary specialization in domestic manufactures of particular kinds of basic industrial materials and types of industrial equipment seems to be a better strategy for these countries to adopt. The mutual exchange of such products under a preferential duty system or any other appropriate regional co-operation scheme, including joint ventures, would widen the narrow national markets and enable the developing countries to produce a wide range of industrial products economically.

Thirdly, until the intermediate and capital goods import-substitution industries begin operation, any large-scale industrial development programmes will require heavy imports of capital equipment and industrial raw materials. Therefore, the liberalization of trade policies by the developed countries for the imports of traditional primary products and potential new export commodities from the ECAFE developing countries, together with increased inflows of foreign aid, will play an important role in promoting industrial development.

Finally, the trade policies of the developed industrial countries and the lack of financial resources in developing countries with which to supply seller's credit to purchasers, continue to be major obstacles to the expansion of an export trade in manufactures and processed goods. The recent adoption of a gen-

eral multilateral and non-reciprocal set of preferential tariffs by some of the industrial countries, including Japan, the European Community and the Nordic countries, will provide some assistance.

However, even if the 18 countries which have signified their intention of adopting this scheme proceed to do so, this would enable the global trade of developing countries to increase by only US\$1 billion a year.² This would be equal to 5.0 per cent of the annual expansion of exports that is required if the Second Development Decade objectives are to be attained.

Furthermore, the structure of tariffs in the richer industrialized countries is such that it is the manufactured exports of the developing countries which are most discriminated against. According to a recent study, tariffs levied on those commodities which are more typical of the manufactured exports of the developing countries, are higher than the tariffs levied on commodities that typically enter into trade between the richer industrial countries. The average nominal tariffs for the two groups of commodities were respectively 7 and 10 per cent in the United States, 9 and 14 per cent in the United Kingdom, and 7 and 9 per cent in the European Community.³

This difference in nominal rates fails to reveal a much greater discrepancy in the effective tariff rates levied on the two classes of goods because tariffs levied on raw materials are much lower than tariffs levied on finished commodities. For example, in the European Community, the tariff on cocoa beans is 3 per cent, while the tariff on processed cocoa products is 18 per cent. In the United States, hides and skins enter duty free, but there are tariffs of 8 to 10 per cent levied on shoes.

The continued use by the richer industrial nations of voluntary and mandatory quota restrictions on the import of light consumer goods continues to discriminate unfairly against the interests of the developing countries. It is this issue, even more than the further reduction of tariffs, which should be the major topic of future international trade negotiations.

Trade, aid and the balance of payments

Tables II-1.5 and II-1.6 set out the recent international trade performance of selected ECAFE countries. While the average rate of export expansion in 1970 was almost twice the average rate experienced in the period 1960-1970, the average performance in

² McNamara, R. S., *Address to Board of Governors of IBRD*, September 1971, p. 26.

³ *Ibid.*

1970 was less impressive than the record performance of 1969. Nevertheless, six of the seven developing countries listed improved upon their export growth performance of the previous year. While no quantitative measure is available, the expansion of exports in real terms would not have been significantly less because there was a tendency for the prices of the exports of developing countries in the region to lag behind general world-wide rates of inflation.

It is interesting to note from table II-1.5 that the three countries with average annual export growth rates in excess of 10 per cent in the 1960s continued such rapid export expansion on average in 1968-1970. They have recently been joined by Indonesia, Malaysia, Singapore and the Philippines, all four of which have placed increasing emphasis on export-oriented policies.

In 1970, for the developing countries in the table considered as a whole, import demand grew at roughly the same rate as in 1969. Generally, the import demand of individual countries was affected by the rate of expansion in their gross national product and by the ability of the country concerned to acquire foreign exchange by drawing upon its international reserves, by the receipt of concessionary and non-concessionary capital flows, and by its export performance.

The evidence so far to hand does not indicate any necessary slowing down in the rate of increase in the value of trade in the region in 1971 as compared with 1970. The table indicates that, in the case of both exports and imports, the number of countries expanding trade more quickly in 1971 than

Table II-1.5. SELECTED ECAFE DEVELOPING COUNTRIES: VALUE AND CHANGES OF TOTAL EXPORTS AND IMPORTS, 1960-1970

	1970 (billion US\$)	Compound percentage annual rates		Percentage changes from previous year				
		1960-1970	1965-1970	1968	1969	1970	1971 ^a	
Hong Kong								
Exports	2.51	13.8	17.1	14.2	24.9	15.4	n.a.	
Imports	2.91	11.0	13.1	13.1	19.4	18.2	n.a.	
Korea, Republic of								
Exports	0.84	38.2	36.7	42.2	36.7	34.2	23.9	
Imports	1.98	19.1	33.8	46.9	24.7	8.7	18.9	
Philippines								
Exports	1.07	6.6	6.8	3.3	0.7	24.9	9.9 ^b	
Imports	1.21	6.3	6.3	9.2	-2.0	-3.5	8.6	
Thailand								
Exports	0.70	5.4	2.3	-3.4	7.6	-1.6	11.1 ^b	
Imports	1.25	10.7	11.2	8.5	8.0	0.9	-4.8	
Malaysia								
Exports	1.68	3.6	6.5	10.7	22.6	1.8	-2.2 ^b	
Imports	1.39	4.3	4.8	6.7	1.6	17.9	—	
Singapore								
Exports	1.55	3.2	9.6	11.5	21.9	0.3	-13.4 ^b	
Imports	2.46	6.3	14.6	15.4	22.7	20.9	20.2 ^b	
Indonesia								
Exports	1.18	3.9	7.6	13.2	14.0	18.7	21.5 ^b	
Imports	1.29	5.0	5.5	3.6	19.1	17.1	10.0 ^b	
India								
Exports	1.96	3.9	3.0	8.7	4.6	6.8	8.3 ^b	
Imports	2.13	-0.8	-4.6	-9.5	-12.3	-3.2	12.9 ^b	
Iran								
Exports	2.37	10.9	12.7	-2.6	11.7	13.1	12.4	
Imports	1.78	12.0	15.6	20.4	14.7	14.1	6.5	
Pakistan								
Exports	0.72	6.3	6.5	11.6	-5.4	6.2	-0.7	
Imports	1.15	5.8	2.0	-6.9	-1.1	13.5	1.5	

Source: IMF, *Annual Report*, 1971, p. 73.

^a Estimates.

^b First two quarters of 1970 compared with the same quarters in 1971.

in 1970 counter-balances those whose rate of expansion is slower. However, the evidence is fragmentary and most of it relates only to trade in the first two quarters of 1971. It is possible that estimates of trade in the second half of the year will not be so favourable because of United States economic policy measures adopted during that period. Among individual country performances, it is encouraging to note the continued expansion in Indonesia's exports and the improved export effort of Thailand. On the other hand, Pakistan's trade in both exports and imports declined.

The decision of the United States to impose quotas on man-made textile imports has had a severe effect on the export prospects of such countries as the Republic of Korea, Hong Kong and Singapore. In all these countries the textile industry is the leading export sector both in terms of its absolute size and in terms of its recent rate of growth, and the United States has been the major single market. In the Republic of Korea, for instance, the export of textiles which comprise over 50 per cent of total exports, has been growing at approximately 40 per cent per annum and more than half of these are sold in the United States. The reduction in the rate of increase of textile imports by volume to 7.5 per cent per annum must adversely affect the Republic of Korea's export prospects and will necessitate, among other things, some revision of the growth targets set in that country's third five-year plan (1972-1976). The other countries have been similarly affected. This is particularly unfortunate as these countries are pursuing their comparative advantage.

Table II-1.7 sets out the recent balance of payments records of a number of the larger ECAFE developing economies. As one would expect, performances vary considerably, but the general impression is one of reasonable stability. Of the eight countries listed, the over-all balance of payments position of five of them improved. Such information, however, does not necessarily disclose the effects of the decline in concessionary aid flows. In the case of India, Ceylon and Pakistan, the inflow of capital on account of the central governments and aid continued its decline. Evidence to hand suggests an even more abrupt decline in 1971.

Data available for 1970 confirms certain trends taking place in the composition and magnitude of the flows of foreign capital to developing countries. Total net capital flows to developing countries as a whole in 1970 approximated US\$15 billion, an increase of nearly US\$1 billion over 1969 in current prices, but in real terms there may have been a fall. Over half of the net capital flow came from bilateral sources and included official and private export credits and private investment. Official development assistance from DAC countries, the major source of concessionary capital flows, increased only slightly above the level reached in 1967 and, as a proportion of the combined GNP of DAC countries, declined to 0.34 per cent. Thus, the general trend in capital flows to developing countries is for the flow of concessionary capital to grow very slowly in absolute terms while growth in non-concessionary capital flows proceeds rapidly.

Table II-1.6. ECAFE DEVELOPING COUNTRIES:
EXPORT PERFORMANCE, 1960-1971

(in million US dollars)

Country	Highest export value recorded from 1960 to 1971	1968	1969	1970	1971
Burma	271 (1963)	111	131	106	104 ^a
Ceylon	409 (1965)	342	322	342	320 ^a
India	2,042 (1971) ^a	1,753	1,835	2,026	2,042 ^a
Indonesia	946 (1971) ^a	751	831	811	946 ^a
Iran	2,354 (1970)	1,879	2,099	2,354	...
Korea, Republic of .	940 (1971) ^a	455	622	835	940 ^a
Laos	6 (1968)	6	4	3 ^b	...
Malaysia	1,680 (1970)	1,347	1,651	1,680	1,618 ^a
Pakistan	723 (1970)	720	681	723	698 ^a
Philippines . . .	1,072 (1971) ^a	848	855	1,062	1,072 ^a
Thailand	792 (1971) ^a	658	708	697	792 ^a

Source: International Monetary Fund, *International Financial Statistics*, November 1971.

^a Six months at annual rate.

^b Estimated.

Table II-1-7. SELECTED DEVELOPING COUNTRIES IN THE ECAFE REGION:
BALANCE OF PAYMENTS SUMMARIES, 1968-1970
(in million US dollars)

	Year	Current balance ^a	Central government capital and aid	Private long-term capital ^b	Short-term capital and net errors and omissions	Over-all balance ^c	Year-on-1 percentage as a percentage of imports per year
Ceylon	1968	-64	43	-2	-10	-33	14
	1969	-142	128	-2	4	-12	9
	1970	-79	83	—	-1	16	11
Philippines . . .	1968	-304	49	102	79	-74	13
	1969	-283	128	90	25	-40	10
	1970	-34	114	125	-107	116	21
Indonesia	1968	-251	213	38	-15	-15	...
	1969	-361	236	43	34	-48	...
	1970	-401	305	56	17	12	...
Iran	1968	-366	407	71	-125	-13	20
	1969	-540	515	102	-58	19	18
	1970	-376	425	111	-283	-102	12
Malaysia	1968	10	16	82	-49	59	44
	1969	216	56	57	-162	167	58
	1970	65	21	67	-124	50	53
Pakistan	1968	-442	453	55	-11	57	25
	1969	-413	323	146	9	65	32
	1970	-698	321	199	40	-106	17
Thailand	1968	-205	96	82	39	12	89
	1969	-275	66	105	68	-36	79
	1970	-319	45	105	100	-69	73

Source: IMF, *Annual Report*, 1971, pp. 122-3.

Note: These IMF balance of payments estimates are not necessarily consistent with estimates in country chapters which are derived from national sources.

^a Balance on goods, services, and private transfers.

^b Capital transactions by local governments are included in private long-term capital to the extent identifiable.

^c Over-all balances are measured here by changes in official gold holdings, in SDRs, in reserve positions in the IMF, in foreign exchange assets, in use of IMF credit, and, where data are available, in liabilities to foreign monetary authorities, including those arising from "swap" transactions. Advance debt repayments by Governments are also treated as a financing item.

Within the ECAFE region as a whole, although there are some pronounced subregional differences, the net transfer of resources has been declining in real and nominal terms. Table II-1-8 sets out data concerning net external resource flows in the region from 1965 to 1969. In east Asia, which includes Indonesia, the Republic of Korea, Malaysia, the Philippines, Singapore, and Thailand total disbursements of contracted loans, grants, etc., increased steadily from 1965 until 1969, but the absolute amount of grants reached a peak in 1968 and dropped abruptly in 1969 to approximately the same level as in 1965. As a proportion of loan commitments and grants, the grant element declined from 59 per cent in 1965 to 47 per cent in 1969.⁴ If allowance is made for amortization and interest payments, the

net transfer of resources to east Asia nearly doubled in terms of current prices between 1965 and 1969.

The experience of south Asia, which comprises Afghanistan, Ceylon, India, and Pakistan, has not been so fortunate. Total disbursements measured in current prices had fallen by nearly 20 per cent between 1965 and 1969 and were well below the peak figure reached in 1967. The grant element as a proportion of loan commitments and grants declined from 77 per cent in 1965 to 68 per cent in 1969.⁴ In terms of the net transfer of resources, the 1969 level was nearly 40 per cent less than that of 1965. In real terms, of course, the difference would be even greater.

⁴ *World Bank Report*, 1971, p. 62.

Table II-1-8. ECAFE DEVELOPING COUNTRIES: EXTERNAL RESOURCE FLOWS AND SERVICE PAYMENTS ON EXTERNAL PUBLIC DEBT, 1965-1969

(in million US dollars)

Area and year	Disbursements			Debt services			Net flow ^b	Net transfer ^c
	Loans	Grants and grant-like ^a	Total	Amortiza- tion	Interest	Total		
East Asia ^a								
1965	509.1	363.4	872.5	163.5*	30.1*	193.6	709.0*	678.9
1966	437.1	308.1	745.2	186.4*	39.1*	225.5	558.8*	519.1
1967	814.6	398.7	1,213.3	205.6	54.1	259.7	1,007.7	953.6
1968	1,033.0	425.2	1,458.2	205.2	79.1	284.4	1,253.0	1,173.9
1969	1,201.5	366.1	1,567.6	318.6	117.6	436.2	1,249.0	1,131.4
South Asia ^d								
1965	1,347.0	827.3	2,174.3	199.5	147.1	346.6	1,974.8	1,827.7
1966	1,226.7	859.9	2,086.6	249.3	178.6	427.8	1,837.3	1,658.7
1967	1,574.5	774.9	2,349.4	306.5	204.5	511.0	2,042.9	1,838.4
1968	1,511.5	520.0	2,031.5	330.5	211.5	542.0	1,701.0	1,489.5
1969	1,418.0	338.6	1,756.6	377.2	240.5	617.6	1,379.4	1,138.9

Source: IBRD, *Annual Report*, 1971, p. 68.^a Grants consist of grant and grant-like contributions by DAC countries and grants by multilateral agencies as compiled by OECD, as well as disbursements by Inter-American Development Bank on loans repayable in recipients' currencies.^b Disbursements on loans, grants and grant-like loans minus amortization on loans.^c Net flow minus interest on loans.^d Does not include most of the publicly-guaranteed private debt of Philippines.^e Interest for Indonesia included in amortization, therefore net flow in this year is understated.^f Excludes suppliers' credits to India for which a complete series of data is not available for 1965-1968. For 1969, transactions on these credits were as follows: disbursements \$89.2 million, amortization \$64 million, interest \$22.9 million.

Table II-1-9 shows how the composition of foreign capital inflow of ECAFE developing countries has altered. It emphasizes the increasing importance of suppliers' credits and official bilateral loans and credits, and the dwindling role of official grants.

Of considerable importance to developing countries is the third allocation of SDRs on 1 January 1972. The third allocation of US\$2.95 billion was made to 112 members at 10.6 per cent of their quotas as of 31 December 1971. ECAFE developing countries were allocated US\$0.27 billion and ECAFE developed countries US\$0.22 billion.

Money and prices

Tables II-1-10 and II-1-11 set out data concerning changes in the money supply and price level of ECAFE developing countries. In a number of cases the effects of tight monetary policies are in evidence. In some cases, for example, the Philippines, the policies have been adopted in response to balance of payments pressures. In other cases, the failure of the

money supply to expand is the result of a stagnant or declining level of domestic economic activity.

Inflationary pressures manifested themselves in the ECAFE region in 1970 and 1971 as in the rest of the world. Table II-1-11 sets out the recent changes in consumer and wholesale price indices for a number of ECAFE developing countries. In part, inflation is imported from the developed economies; in part, it is a result of excess demand pressures within the country concerned. With few exceptions the rate of inflation of ECAFE developing countries in 1970 was below the world average for developing economies of 9 per cent. Among other countries, Burma, Ceylon, India, Iran, Malaysia, Pakistan, Singapore and Thailand all had consumer price index increases of less than 6 per cent, which is less than the average rate of inflation experienced in the developed industrial nations in 1970. Present indications are that this record is being maintained in 1971. Exceptions have occurred in those countries where rapid price increases have resulted from extended war efforts (the Republic of Viet-Nam), crop failure (Afghanistan) and devaluation (the Philippines).

Table II-1-9. DISTRIBUTION OF LOANS AND GRANTS TO SELECTED
ECAFE DEVELOPING COUNTRIES, 1965-1969

(in percentages)

	Private loans and credits			Official grants	Official bilateral loans and credits	Multilateral loans and credits	Percentage of world total
	Suppliers	Other private	Total				
<i>East Asia^a</i>							
1965	20	16	36	41	16	7	10
1967	26	4	30	33	31	6	12
1969	27	8	35	25	33	7	15
<i>South Asia^b</i>							
1965	4	1	5	35	47	13	25
1967	6	1	7	31	48	14	24
1969	10	1	11	18	58	13	17

Source: IBRD, *Annual Report, 1971*, p. 62.^a Includes Indonesia, the Republic of Korea, Malaysia, the Philippines, Singapore and Thailand.^b Includes Afghanistan, Ceylon, India and Pakistan.Table II-1-10. ECAFE DEVELOPING COUNTRIES:
CHANGE IN MONEY SUPPLY

(in percentages)

Country	Annual compound rate of growth 1960-1968	1968	1969	1970	1971
Afghanistan	11.1 ^a	7.3	18.2	5.3	-0.8 ^b
Ceylon	5.9 ^a	5.9	-1.5	4.6	8.2 ^c
India	9.0 ^a	5.6	12.0	12.6	9.7 ^d
Indonesia	162.5	118.4	58.14	34.7	...
Iran	16.0 ^a	10.6	9.7	8.1	...
Korea, Republic of	29.5 ^e	25.9	42.1	40.1	4.3 ^b
Malaysia, West	5.1 ^a	11.4	13.3	7.7	-0.1 ^c
Pakistan	9.5 ^a	7.4	14.3	11.1	10.3 ^d
Philippines	9.6 ^a	3.5	23.6	8.9	1.8 ^b
Thailand	10.5 ^e	8.1	3.4	8.6	0.1 ^e
Viet-Nam, Republic of . .	28.3 ^a	48.5	13.3	14.8	15.1 ^e

Source: International Monetary Fund, *International Financial Statistics*.^a 1960-1968.^b 1961-1968.^c As of 31 August 1971.^d 1963-1968.^e As of 31 July 1971.^f As of 30 June 1971.^g Last Friday of June 1971.

Table II-1-11. ECAFE DEVELOPING COUNTRIES: PERCENTAGE RATES OF CHANGE IN CONSUMER AND WHOLESALE PRICE INDICES^a

Country	Annual compound rate of growth ^b 1960-1968	1967	1968	1969	1970	1971 ^c
Ceylon	2.0	2.2	5.9	7.3	5.9	3.0
Hong Kong	—	5.7	2.7	3.5	7.6	6.2
India ^b	7.2 (6.8)	13.9 (14.9)	2.6(-0.1)	-0.01 (2.0)	5.1 (6.4)	3.8 (3.6)
Indonesia	185.7	169.5	125.3	6.1	12.3	8.1
Iran	1.5 (1.0)	1.6 (0.3)	0.7 (0.5)	3.6 (2.2)	1.7 (3.2)	2.4
Khmer Republic	—	-0.01	6.0	6.3	11.9	41.7
Korea, Republic of ^d	13.6 (13.6)	10.8 (6.4)	11.1 (8.1)	10.1 (6.8)	12.7 (9.1)	13.1 (9.1)
Laos	—	7.9	5.1	3.1	0.3	0.7
Malaysia, West	1.0	4.2	1.0	-0.01	1.3	1.4
Pakistan ^e	3.3 (4.0)	6.9 (13.8)	0.2(-0.04)	3.2 (5.8)	5.4 (2.9)	5.1
Philippines ^f	4.9 (4.7)	6.9 (4.7)	0.6 (2.9)	3.2 (0.7)	5.0 (19.4)	—
Singapore	—	3.3	0.7	—	0.3	1.0
Thailand ^g	2.2 (2.6)	4.0	2.2	2.1	0.8	1.9
Viet-Nam, Republic of	—	43.8 (33.1)	26.9 (8.8)	22.0 (19.5)	36.6 (23.9) ^h	30.0

Source: United Nations, *Monthly Bulletin of Statistics*, December 1970.

^a Rates of change in wholesale prices are the figures which appear in brackets.

^b Base year 1960 = 100.

^c Year ending 30 June.

^d Base year 1965 = 100.

^e Consumer price index for industrial workers only.

^f Base year 1961 = 100.

^g Estimate for Bangkok only.

C. Economic developments in the ECAFE region: developed economies

The major indicators of economic development in the three developed countries of the ECAFE region are given in table II-1-12.

All three economies share a common problem, namely that the rate of inflation is excessive and that its causes can be attributed more to cost/push than to demand factors. In Australia and New Zealand, agricultural output is sluggish or declining, although the level of industrial output remains buoyant.

Table II-1-12. ECAFE DEVELOPED ECONOMIES: MAIN ECONOMIC INDICATORS (percentage annual changes)

	Japan ^a		Australia ^b		New Zealand	
	1970	1971 ^c	1970	1971 ^c	1970	1971 ^c
GNP (real)	9.7	4.1	5.6 ^d	3.9 ^d	4.7	5.5
Agricultural production	...	...	-4.0	-3.0	-2.0	1.0
Industrial output	13.7	2.8	5.0	...	5.3	7.0
Exports	16.3 ^e	9.4 ^e	23.0	6.5	14.1 ^e	2.2 ^e
Imports	18.0 ^f	-0.9 ^f	11.0	6.2	14.6 ^g	24.6 ^g
Consumer price index	7.3	4.8	3.2	4.8	6.5	9.2

Source: See individual country papers in Part II of this Survey.

^a Fiscal year commencing 1 April.

^b Fiscal year ending 30 June.

^c Estimate only.

^d Gross domestic product.

^e Goods and services.

In Japan, the two major policy issues other than inflation are the persistent surplus in the balance of payments and the recession in the level of business activity. Current indications are that, despite the revaluation which has occurred in the yen, the balance of payments surplus could increase in 1972 because of the relatively greater effect of the recession on imports than of other measures aimed at reducing the rate of growth of exports. At present, the level of private investment activity is actually declining in relation to its level of a year ago. Because the effects of an increase in public investment

expenditure are subject to a lag it will be some time before the planned increase in such expenditure has its effect on the level of economic activity and on the balance of payments. In the meantime, it is probable that Japan will reduce some of its controls on imports and increase its foreign aid programme. To some extent, however, the slowdown in the rate of increase in activity in the Japanese economy will adversely affect the raw material exports of other countries in the ECAFE region in late 1971 and early 1972.

Chapter II

THE INTERNATIONAL MONETARY SITUATION

A. Historical background

The international monetary mechanism which was based on the Bretton Woods system, as reflected in Fund Articles and practices, depended on the stability of exchange rates around par values that were fixed and agreed with the Fund. The recent pervasiveness of inflationary conditions in several leading industrial countries, the ineffectiveness of the Fund in enforcing necessary fiscal and monetary discipline in their policies, and the reluctance of some of these countries to affect appropriate changes in exchange rates in time and in a manner most likely to restore equilibrium in their payments, threatened the successful functioning of the system. Only a small proportion of current gold output accrued to monetary reserves during the 1960s, and the growth of international liquidity depended mainly on United States payments deficits.

As of mid-1971, official gold holdings, at US\$41.27 billion, were no higher than at the end of 1962, and were lower than during 1964-1966. According to data published by the Fund, total reserves increased at only 2 per cent a year during 1960-1964 and at 0.9 per cent a year during 1965-1968; yet, during this period, world trade recorded buoyant expansion. Following protracted discussions, it was agreed that the Fund should create SDRs, an unconditional reserve asset, in specified amounts, and allocate them to member countries of the Fund according to their quotas: 3.41 billion SDR units equivalent to US\$3.41 billion were allocated to 104 participants at 16.8 per cent of their quotas on 1 January 1970, US\$2.95 billion amount was allocated to 109 members at 10.7 per cent of quotas on 1 January 1971 and US\$2.95 billion was allocated to 112 members at 10.6 per cent of their quotas on 1 January 1972. There has also been a quinquennial review and revision of quotas, which increases members' drawing facilities from the Fund.

The later 1960s were characterized by recurrent crises in gold and foreign exchange markets. There was basic disequilibrium in the payments position of some of the leading industrial countries, some having persistent surpluses and others deficits. In March 1968, the two-tier gold system was devised, whereby leading central banks agreed no longer to supply gold from reserves to private markets. Following large-scale speculative buying of the deutsche mark, the German authorities closed official exchange markets

towards the end of September 1969, and on 24 October 1969, a new par value was set for the German currency reflecting an upward revaluation of 9.29 per cent. Canada floated its currency on 31 May 1970.

The undervaluation of the deutsche mark, until it was revalued in October 1969, helped German exports, and the undervaluation of the yen over the years has been a main element in the dynamism of Japanese exports and the growth of the Japanese domestic economy. Inflation in the United States, which made its exports less competitive and brought in larger imports to the United States market, resulted in a persistent payments problem for the United States. The current account surplus dwindled over the years and proved inadequate to cover net investments and government outlays abroad. In 1970, an easy monetary policy was adopted in the United States to combat the continuing recession in domestic economic activity, but, in the Federal Republic of Germany and some other leading industrial countries, monetary policy was one of credit restraint. Mainly due to the resulting interest rate differentials, there were sizable flows of short-term capital funds from the United States during 1970 to the Euro-dollar market.

The interest rate differentials had narrowed by March-April 1971 but by then speculative forces had taken hold. The outflow of funds from the United States, initially into the Federal Republic of Germany but later into some other countries, especially Japan, assumed massive proportions in anticipation of changes in currency parities. During April-May, these speculative factors were more important than mere interest rate differentials. The capital flows were superimposed on an international payments situation that was itself clearly unsatisfactory. The exchange markets were all in turmoil. The Federal Republic of Germany and the Netherlands floated their currencies on 10 May 1971; Switzerland and Austria revalued their currencies. Several other currencies joined in floating in quick succession.

Faced with inflation and unemployment, and a precarious balance of payments situation, on 15 August 1971, the United States announced a series of measures, domestic and external, including suspension of the conversion of dollar balances into gold and other reserve assets and the imposition of a 10 per cent import surcharge on non-quota imports. As all other currency values were defined in terms of

dollars, the floating of the dollar dismantled the international monetary arrangements based on the Bretton Woods agreements. Most of the main currencies were floating against the dollar, but varying restrictions were imposed by the respective countries that inhibited free floating; the controlled nature of the floating also manifested itself in the lopsided nature of cross rates, especially among the deutsche mark, the yen, and the French franc.

Chiefly due to the outflows of short-term funds from the United States, total monetary reserves (gold, SDRs, reserve positions in the Fund, and foreign exchange) increased by as much as 22 per cent in 1970 and the further accretion during January-September 1971 has been similarly large, in percentage terms. These additions to reserves have gone mostly to a few industrial countries—the Federal Republic of Germany, Japan, Switzerland, France, and the United Kingdom. These recent accretions to international liquidity, from the huge buildup in holdings of United States dollars abroad, are of doubtful value from the viewpoint of the trade and other requirements of nations. Being highly volatile, their quality differs from the other components of reserves.

As for developing countries, their reserves formed 21 per cent of total international reserves at the end of 1969; the proportion being a little less than 20 per cent at the end of 1970; and, by June 1971, it was 18.5 per cent. In 1970, total exports of developing countries were US\$54 billion, or 19 per cent of world exports, as against 23 per cent in 1963 and even larger share in the 1950s. Thus, while they have been losing relatively in trade over years, developing countries have not materially gained from the large additions to international reserves during 1970 and 1971; in fact, but for SDR allocations, their absolute position is likely to have worsened as compared with 1969. They were in no way responsible for the confusion in the international monetary situation. The responsibility was with the leading industrial countries, so was the confrontation among them.

The United States stated that a removal of its import surcharge was conditional upon action by other leading countries to let their currencies float freely and upon their taking specific steps to reduce barriers to United States exports. In the United States view, any change in the price of gold would be a retrograde step; the objective should be to reduce and eventually eliminate the role of gold in the international monetary mechanism. The United States was of the opinion that a US\$11-13 billion improvement in its current account position was required, but other leading industrial countries took

the view that the turn-round for the United States current account need be only of the order of US\$6-8 billion.

If the disturbed and uncertain international situation had persisted, there was a danger that it might lead to retaliatory actions on the part of leading industrial countries and that the rate of increase in the value and volume of world trade would be affected. Should such a development have occurred, the effects upon developing countries would have been severe. Already confronting a dwindling flow of foreign assistance in real terms and a generally adverse shift in their terms of trade as a result of the inflation in the richer industrial nations, further restrictions upon access to export markets would have exacerbated debt-servicing problems and seriously affected development efforts.

B. Current developments

The crisis provided an opportunity and an impetus for reform, not a piecemeal approach to merely re-establish the old Bretton Woods system, but a comprehensive reform that would cover the mechanism of exchange rate adjustment and allow for appropriate increases in international liquidity. In his concluding remarks at the closing joint session of the 1971 annual meetings of the Boards of Governors of the Fund and Bank Group, Mr. Schweitzer noted five issues on which there was a substantial measure of agreement; (1) failure to find a solution would entail real dangers; (2) substantial adjustment was required to deal adequately with the current imbalance in world payments, through the expeditious establishment for the major currencies of a realistic new structure of parities; (3) the realignment of currencies had to be accompanied by the introduction of some temporary widening of margins; (4) normal conduct of Fund operations needed to be resumed as promptly as possible; and (5) the longer-term evolution of the international monetary system should include a major increase in the role played by an internationally manager reserve asset—specifically SDRs—in the world reserve system. A resolution of the Executive Directors of the Fund was unanimously adopted by the Governors at the 1971 annual meetings calling upon all members “as promptly as possible” to “establish a satisfactory structure of exchange rates, maintained within appropriate margins, together with reduction of restrictive trade and exchange practices” . . . and the Executive Directors were to report “without delay” to Governors on “measures that are necessary or desirable for the improvement or reform of the international monetary system.”

After intensive, bilateral and other, discussions and negotiations, the Group of Ten hammered out a set of new parities among the leading currencies. Accordingly, on 18 December 1971, the United States announced its decision to devalue the dollar by 7.89 per cent in terms of gold, by raising the price of gold from US\$35 to US\$38 per fine ounce. This action awaits Congress approval. There was no change for the pound sterling, the Swiss franc or the French franc in terms of gold. The other major currencies, except the Canadian dollar which continues to float, were revalued in varying degrees. The over-all average appreciation of major currencies in relation to the dollar is said to be 10 per cent, the Japanese yen showing 16.9 per cent revaluation, followed by the deutsche mark at 13.6 per cent, and other currencies less. The new parities would be allowed to fluctuate by up to 2.25 per cent either way. The new set of parities and wider margins has been approved by the Fund. On 20 December 1971, the 10 per cent import surcharge was removed by the United States.

Now that the leading currencies are realigned and new parities have been set for them, many developing countries of the ECAFE region have realigned their own currencies. Thailand, Nepal, the Philippines, the Republic of Korea, and Indonesia are maintaining their currency values unchanged with the United States dollar; Burma has devalued against the dollar by 10.97 per cent; Malaysia retains the gold parity, with sterling; and India revalued 3.03 per cent against the dollar by linking itself with sterling at its latest floating market rate.

C. Unresolved problems

The realignment of currencies is an important first step towards a properly reformed international monetary system. There remain, however, important areas of uncertainty. These concern the policies that are to be carried out by the large industrial countries to restore full employment and reasonably rapid rates of economic growth; and the way in which the international monetary system is reformed to ensure the provision of adequate international liquidity, and to make future exchange rate adjustments easier. These areas of uncertainty are related: the willingness of countries to carry out expansionary domestic policies at the possible cost of a deterioration in their balance of payments is, to a considerable extent, determined by the availability of international liquidity and by the degree of rigidity of exchange rates. The significance of this point becomes apparent when the role of the United States balance of payments deficits in the present operation of the international monetary system is considered. The

United States deficits have been the main source of international liquidity since the early 1950s. If this source disappears as a result of the elimination of the deficit, a shortage of international liquidity may develop. This could induce countries to resort to contractionary domestic and restrictive trade policies. Furthermore, to the extent that other countries succeed in protecting their balance of payments surpluses, the United States will fail to reduce its deficit.

There is general agreement that a comprehensive reform of the international monetary system is needed, and that an internationally managed reserve asset — such as SDRs — should be predominant in the world reserve system. But there is not yet agreement about the specific nature of the reform required. At present, developing countries are excluded to a considerable extent from the decision-making process. Nevertheless, they are profoundly concerned that the international monetary system should function properly. They have also a particular interest in the method used for the allocation of new liquidity (SDRs), and especially whether or not this should be linked to development aid.

D. Likely impact on ECAFE developing countries

The move towards more flexible exchange rates in recent months has taken two forms. First, there has been a widening of the margins around parity in which exchange rates are permitted to fluctuate. Secondly, there has been increased recognition of the desirability of less rigid rates by various institutions and authorities.

The adoption of less rigid exchange rates by the developed countries — which of course does not necessarily imply floating rates — should have two beneficial effects on the developing countries. First, the reluctance for balance of payments reasons of some developed countries to give aid and to liberalize imports should be reduced. Secondly, the ability of the developed countries to maintain reasonable levels of employment and economic growth, without fear of a balance of payments crisis, is likely to result in a faster and more stable rate of growth in demand for the goods and services of developing countries. Furthermore, protectionist pressures within the developed countries are unlikely to be so strong under conditions of full employment and growth, so the possibility of the liberalization of controls on imports on specific industries, such as textiles, is also enhanced.

One of the standard objections to exchange rate changes is that they increase uncertainty. Frequent changes in the exchange rates of developed countries could cause uncertainty in developing countries about

their terms of trade, stability of markets, and the value of foreign credits and liabilities. However, exporters and importers can always hedge in the forward exchange markets. Moreover, uncertainty has also come to exist under a system of rigid exchange rates. In the light of experience since the Second World War, there can never be total confidence that any exchange rate will not in fact be altered. Furthermore, there can be uncertainty about alternative measures that might be used instead of an exchange rate adjustment, e.g. import surcharges, sudden reductions in aid, controls on foreign investment, or fiscal policies aimed at reducing aggregate demand and the demand for imports. All of these measures impose problems for commerce and industry in developing countries and are likely to be just as serious as problems arising from frequently adjusted exchange rates.

Nevertheless, a move towards more flexible parities and the realignment of exchange rates makes explicit a problem of economic management: namely, to what currency, if any, should the value of a developing country's currency be tied. To leave the currency permanently aligned to that of one other country, when exchange rates between other countries are frequently changing, is likely to result in a sub-optimal exchange rate for the developing country. Individual developing countries are therefore likely to find it necessary to operate positive exchange rate policies and to be prepared to alter their rates to meet changing circumstances, including exchange rate realignment by the developed countries.

The impact of the exchange rate realignments on developing ECAFE countries, as distinct from the impact of increased exchange rate flexibility, will depend upon the response of the developing countries to the alignments of the exchange rates of the developed countries and upon the general economic situation consequent to these changes. In particular, it will depend upon whether developed countries are prepared to expand their economies or whether they will continue to protect their respective balance of payments by contractionary domestic policies and import restrictions.

Provided that the changes in exchange rates are accompanied by expansionary policies on the part of the developed countries, several favourable developments can be anticipated. First, to the extent that the rate of economic growth in the United States accelerates, there would be an increased demand for primary products and a weakening of the protectionist lobby against manufactured imports. Secondly, with a removal of international uncertainties, the reflation of economic activities in developed countries should proceed more rapidly, with associated positive

effects on their imports from developing countries. Some shift in demand for certain types of manufactured goods to the more advanced of the developing countries in the ECAFE region can also be anticipated. Finally, there may be a flow of investment capital from appreciating industrial countries to the developing countries in order to take advantage of the increased competitiveness of the latter.

The exchange rate changes will also cause some difficulties for the developing countries. In particular, the cost of their imports from the appreciating countries will tend to rise. In many cases, however, this could lead to a more realistic pricing of imports and encourage desirable import substitution. Another problem concerns the value of foreign exchange reserves held by developing countries. To the extent that these are held in United States dollar units, their real value will have fallen. The seriousness of this loss will depend upon the structure of each country's trade as well as upon the structure of the foreign exchange reserves. On the other hand, developing countries which have liabilities—either private or official—denominated in terms of United States dollars gain to some extent from the devaluation of the dollar.

It is difficult to generalize about the effect of the exchange rate changes on the balance of payments of the developing countries, but most of the countries that have no or only a small appreciation of their exchange rate relative to the dollar can expect some improvement in their balance of payments in the intermediate term because of the effective depreciation of their exchange rates relative to other major trading countries. If the current changes in the international monetary situation result in expansionary conditions as described above, then the total effect, once the adjustments to the price changes have been made, should be favourable to the developing countries. However, if appreciating countries are not able to maintain output at full employment level and if the shortage of international liquidity results in surplus countries resisting any weakening of their balance of payments, the outlook for the developing countries will be less favourable.

E. Conclusions

The adoption of more flexible exchange rates and the realignment of currency values are likely to be beneficial to developing countries, providing that these changes occur in a way that encourages an expansion of world economic activity and trade.

More frequent changes in the exchange rates of the industrial countries should create no serious

problems for developing countries, although the latter countries would themselves be well advised to adopt more positive exchange rate policies so as to facilitate adjustment to such changes.

The specific realignment of currency values might cause some problems to particular countries in the short run. These are unlikely to be severe once there has been time for adjustments to the relative price changes to occur, and they should be negligible when compared with the beneficial effects of an expanding world economy.

Because of the importance of the international monetary system in providing a setting in which the

world economy can expand, the authorities of the developing countries should do their best to ensure that the realignment of exchange rates is accompanied by measures for the expansion of international liquidity, including aid. In particular, the interest of the developing countries in the operation of the international monetary system should be fully recognized in the institutional reforms that emerge.

As far as ECAFE developing countries are concerned, the increased willingness of countries to cooperate in seeking satisfactory international financial arrangements augurs well for the development of regional projects, such as the Asian Clearing Union and an Asian Reserve Bank.

Chapter III

CURRENT ECONOMIC DEVELOPMENTS AND POLICIES IN THE COUNTRIES OF THE ECAFE REGION

Afghanistan

Introduction

Afghanistan's GDP declined by 2.7 per cent during 1970/71 due mainly to a severe drought. Agricultural production dropped sharply and food-grain prices soared. Exports increased marginally while commercial imports rose. Foreign debt servicing liabilities increased further and the inflow of project aid fell. The balance of payments recorded a deficit on current account.

Table II-3-1. AFGHANISTAN:
MAJOR ECONOMIC INDICATORS^a

(Per cent changes)

	1969/70	1970/71
1. GDP (at 1965/66 prices)	2.9	-2.7
2. Money supply	18.2	5.3
3. Exports (US\$ million)	81.9	83.6
4. Commercial imports (US\$ million)	72.5	76.0
5. Development imports (US\$ million)	44.2	27.6
6. Change in foreign exchange reserves (US\$ million)	-5.0	0.1
7. National price index (1961/62 = 100).	-3.6	29.0

^a Fiscal years ending 20 March.

Major economic developments

Drought conditions prevailed in Afghanistan during 1970/71. The national index of precipitation fell from an average of 100 in the previous 14 years to 70 in 1970/71. As a result, agricultural output declined sharply. All important crops suffered, but the hardest hit were wheat and cotton, the production of which declined by 15 per cent and 10 per cent respectively.¹ The contribution of the agricultural sector to GDP declined by 10 per cent as against an increase of 2.3 per cent in 1969/70.² Although foodgrain imports were increased substantially as the level of commodity assistance rose from \$10 million in 1969/70 to \$14.7 million in 1970/71,

cereal prices increased by 48 per cent during the years. Given the importance of foodgrains in the over-all price index, the fact that the latter rose by only 29 per cent indicates that the other prices generally declined. Performance in manufacturing was weak. Production of woollen textiles and cement declined by 34 per cent and 9 per cent respectively, as a result of reduced real incomes and a slowdown in development activity.

Government revenue increased by 12.1 per cent to Af 5,718 million in 1970/71 while current expenditure rose by 8 per cent due mainly to increased debt servicing and food subsidies. Deficit financing was reduced from Af 1,088 million in 1969/70 to Af 540 million in 1970/71. Development expenditure in local currency dropped by about 9 per cent to Af 1,743 million, while total development expenditure in the public sector declined by over 23 per cent to Af 2,984 million during the year.

Export earnings increased by 2 per cent to \$83 million in 1970/71. The increase was accounted for entirely by exports of natural gas while earnings from traditional exports declined. Commercial imports rose by 4.8 per cent. The balance of payments on current account showed a deficit of \$9.9 million in 1970/71 as against the deficit of \$9 million in the previous year. Debt servicing liabilities increased from \$23.7 million in 1969/70 to \$26.2 million in 1970/71. At this level they were over 26 per cent of the total foreign exchange earnings of Afghanistan.

Recent measures

Measures have been taken recently to improve economic performance. The Agricultural Bank has been reorganized with the assistance of the World Bank and UNDP and it has expanded its activities. The legislation establishing an Industrial Bank with the assistance of the World Bank has been passed by Parliament and the Bank is likely to start functioning shortly. The new civil service law, which provides for better working conditions and social security benefits, is likely to improve administrative efficiency.

To salvage as much agricultural production as possible and to provide relief for the drought-afflicted rural population, the Government has been operating an emergency relief and works programme, under

¹ See *Survey of Progress, 1970-1971*, Ministry of Finance, Government of Afghanistan.

² *Ibid.*

which it has distributed improved seeds and fertilizers in areas where water was available and cultivation possible. In other areas, wheat was distributed in payment of wages for such work as the digging of wells, construction of roads and repair of canals.

In view of the increasing burden of debt servicing, the Afghan Government requested the donor countries in September 1971 to grant it a moratorium for two years and to reschedule debt repayments. The response from all donor countries was favourable.

Outlook for 1971/72

The prospects for 1971/72 do not appear very encouraging. The drought has continued this year with greater severity. The national index of precipitation has dropped to as low as 57. The forecast for the wheat crop stands at 1.915 million tons which is 7.9 per cent lower than last year and about 22 per cent lower than output in a normal year. Other crops could be similarly affected and livestock numbers are likely to be reduced substantially.

Since wool, karakul, fruits and nuts are Afghanistan's main traditional exports and the output of most of these items is likely to decline, export earnings from traditional exports may again decrease. Even if allowance is made for the likely further increase in gas exports, over-all export earnings may at best remain stagnant. Food imports, on the other hand, will need to be increased substantially; they may have to be at least partly financed out of Afghanistan's own resources. The balance of payments is likely to be under increased pressure unless a moratorium on foreign loans is granted in the near future.

There seems to be little prospect of a reversal in the declining trend in foreign project assistance. Particularly is this so in view of the deteriorating aid climate. It is also difficult for Afghanistan to provide complementary domestic resources. There are, therefore, prospects of a decline in GDP in 1971/72, a further rise in the cost of living, a continuation of depressed business conditions and a further increase in unemployment.

Australia

Introduction

The Australian economy in 1970/71 was marked by the emergence of cost-push inflation which was not responding to the use of conventional aggregate demand measures. At the same time, the level of unemployment has increased above the normally tolerated limit and the balance of payments situation has led to a very large accumulation of international

reserves. Table II-3-2 sets out the major economic indicators for the economy.

Table II-3-2. AUSTRALIA:
MAJOR ECONOMIC INDICATORS

(in million Australian dollars, current prices)

	1969/70	1970/71
Gross domestic product (current prices)	30,107	33,028
Farm output (current prices)	2,163	1,904
Non-farm output (current prices)	27,956	31,134
Exports (f.o.b.)	3,967	4,218
Imports (f.o.b.)	3,553	3,788
International reserves	1,678	2,280
GDP (per cent increase in constant prices)	—	3.9
Exports (per cent per annum increase in current prices)	23.0	6.5
Imports (per cent per annum increase in current prices)	11.0	6.2
Consumer price index (1966/67 = 100)	109.4	114.6

Source: Commonwealth Bureau of Census and Statistics.

Recent economic changes

(a) *Wages and prices*

The most serious problem facing the Australian economy in 1971 was the inflation brought about by wage-push pressures. The consumer price index, which had been almost stable for several years in the early 1960s, rose by 6.5 per cent in the year ending September 1971. The faster pace of inflation coincided with a slackening in the labour market, registered unemployment rising from a low point of 0.9 per cent in April 1970 to 1.5 per cent in September 1971. During the twelve months to the June quarter of 1971, wage rates increased by 10.9 per cent and average earnings by 13.4 per cent, and, as a consequence, wages, salaries and supplements rose from 58 per cent of the gross domestic product at factor cost in 1969/70 to 61 per cent in 1970/71.

The upsurge of wage-push inflation was generally thought to be a delayed consequence of the full employment that the Australian economy had enjoyed, with only minor lapses, since the end of the Second World War. Trade unions had become more demanding, and one consequence of the rising expectations of employees was an increase in the frequency and severity of industrial disputes. The number of working-days lost through involvement in disputes rose from a low point of 705,000 in 1967 to 2,394,000 in 1970, and, in the first eight months of 1971, was 32 per cent higher than it had been a year earlier.

(b) Expenditure

The fiscal year 1970/71 was marked by a rise in the share of Government, and a decline in the share of private consumption in gross domestic expenditure and by a fall in the public and a rise in the private share of gross capital formation expressed as a proportion of gross domestic expenditure. The decline in the share of private consumption was partly a result of a decline in the sector's propensity to consume out of disposable income and to the increasing incidence of taxation.

(c) Production

On the basis of preliminary estimates, gross domestic product at constant prices increased between 1969/70 and 1970/71 by almost 4 per cent. As the average level of employment rose between the two years by 3.7 per cent, the implication is that labour productivity increased by only about 0.2 per cent. The productivity increase in the previous year had been about 1.5 per cent, and, in the year before that, about 4.8 per cent. During the 1960s as a whole, production per employee rose by an average of about 1.7 per cent per annum. The variations in productivity were due mainly to changes in seasonal conditions in rural industry.

The largest increases in production between 1960/70 and 1970/71 were in the field of minerals. Crude oil production rose threefold to 93.9 million barrels for 1970/71, as a result of the development of the Gippsland field off the Victorian coast. Production of natural gas increased by 150 per cent to 69,000 million cubic feet, chiefly from the new Victorian and South Australian fields. Mine output of nickel concentrate rose by 87 per cent to 292,000 tons. There were increases of 34 per cent in bauxite to 10.9 million tons, 32 per cent in iron ore and concentrate to 55.9 million tons, and 23 per cent in copper to 168,000 tons. Production of lead, zinc and gold fell, however, by 12 per cent, 14 per cent and 7 per cent respectively.

At the mineral processing level, there were increases of 18 per cent in the output of alumina and 30 per cent in the output of refined aluminium. Production of iron ore pellets rose by 16 per cent. There were smaller increases in the output of pig iron and refined copper.

The fortunes of the building industry were variable. Expenditure on new houses and flats and government construction expenditure was almost stagnant in 1970/71 compared with 1969/70, but statistics for the first quarter of 1971/72 indicate an increase in the rate of construction activity in both areas. Private business construction expenditure

remained buoyant in 1970/71 and approvals for construction in the first three months of 1971/72 were running 21 per cent above those of a year earlier.

The output of motor vehicles had reached a record level of 481,000 units in 1969/70, but declined to 453,000 units in 1970/71. There was a sharp recovery in the first two months of 1971/72 to the equivalent of an annual rate of about 500,000.

Rural output fell in 1970/71, though by less than the 4 per cent decline of the previous year. Wheat production was down by about 30 per cent as a result of lower quotas and adverse seasonal conditions. Deliveries of wool were 7 per cent lower than in 1969/70, and the output of scoured and carbonized wool fell almost twice as far. There were rises in the production of sugar, butter, meats, and cereals other than wheat. Although the level of farm stocks declined during 1970/71, there was a substantial carry-over of wheat and wool at the end of the financial year as a result of government acquisition policies.

(d) Foreign trade and payments

Between 1968/69 and 1969/70, merchandise exports, measured at current prices, increased by 23 per cent, and imports by 11 per cent. The increases in 1970/71 were much lower at 6.5 per cent and 6.2 per cent respectively. The credit balance of \$430 million on merchandise trade in 1970/71 was more than offset by the net deficit of \$1,207 million on transportation, investment income and other invisible items, although this was only 2.6 per cent higher than in 1969/70. Capital inflow continued its momentum to yield a net \$1,378 million for the year. In consequence there was an increase of \$602 million in the economy's net reserves of gold and foreign exchange, as compared with an increase of \$37 million in the previous year. At the end of June 1971, the official reserve assets stood at \$2,280 million, which was equal to 45 per cent of total imports of goods and services during the year.

The September quarter of 1971 produced a further merchandise trade surplus of \$147 million, a deficit on invisibles of \$307 million, and thus a current account deficit of \$161 million. The net apparent capital inflow of \$420 million led to a further rise in reserves of \$259 million.

A decline of 28 per cent in the value of wool exports, arising from reductions in both quantity and price, was a major factor in the slackening in the rate of growth of exports between 1969/70 and 1970/71. In 1970/71, for the first time, non-rural exports were roughly equal to rural exports.

About 40 per cent of the decrease in the rate of growth of imports in 1970/71 was accounted for by a reduction of \$66 million or 26 per cent in imports of petroleum, as a result of the development of the Gippsland field. On the other hand, imports of iron and steel rose by \$43 million or 45 per cent because of the failure of domestic production to keep pace with demand.

Recent policy developments

(a) Employment and inflation

Although the goals of Australian economic policy are seldom announced, it is possible from time to time to infer particular targets from the pronouncements and actions of the Federal Government.

During the period from 1965 to 1969, an unemployment level of about 1.0 to 1.3 per cent of the labour force seemed to be acceptable to the Government, together with a rate of increase of about 3 per cent per annum in consumer prices.

The consumer price index began to exceed the accustomed rate of increase at the end of 1969 and unemployment passed the customary target in the middle of 1971. The inflation was clearly of the wage-push type which had already become a serious problem in Britain and other Western European countries. In this situation the slightly deflationary federal budget of August 1970 could do little more than induce unemployment.

During 1970, the Commonwealth Arbitration Commission, which through its wage awards tends to set the level of prescribed minimum wage and salary rates throughout Australia, found its influence on the industrial scene diminishing noticeably. The symptoms of this reduction in authority were the rapid growth of strikes and the widening gap between award wages and the amounts that trade unions were actually extracting from employers.

The reaction of the Federal Government to the acceleration of wage-push inflation was to apply the remedies appropriate for demand-pull inflation. In February 1971, it suspended the provision under the income tax law for a 20 per cent investment allowance on manufacturing plant and equipment. In May, it announced a reduction in the immigration target for 1971/72 from 170,000 to 140,000 settlers and the federal budget for 1971/72 contained tax increases which would increase revenue by 12.8 per cent. The Government's domestic outlay was to go up by only 11.7 per cent, a good deal less than the 14.9 per cent rise of the previous year.

Monetary policy was used in a contrary direction with the first major reductions in government interest rates taking place since 1961. These interest reductions were in part response to the downward trend in interest rates which has been occurring overseas.

(b) The allocation of resources

The comparatively modest growth performance of the Australian economy in the period since the Second World War was due in part to the small and scattered nature of the domestic market, which made it difficult to take full advantage of economies of scale in production and distribution, and limited the scope of maintaining efficiency through competition.

The tendency towards the proliferation of relatively small-scale enterprises and industries was reinforced by the long-established policy of tariff protection. In its report for 1970/71, the Tariff Board estimated that the average rate of available effective protection for each of the thirty-one manufacturing industry groups in the economy, measured in relation to their value added, varied from zero to 120 per cent, with a weighted mean of 46 per cent. In April 1971, the Minister for Trade and Industry announced that the projected general review of the level of protection would begin with the tariffs on machinery and metal manufactures.

In May 1971, federal legislation was passed to extend the coverage of the Trade Practices Act to prohibit resale price maintenance and the new provisions came into force in August.

Further attempts were made during 1971 to remedy the depressed state of some sectors of rural industry. In December 1970, the federal and state governments had reached agreement in principle on a rural reconstruction scheme, under which there would be an adjustment of farmers' debts and financial support for farm improvement and for the retraining of sub-marginal farmers for employment outside rural industry. The training scheme came into operation at the beginning of October 1971. The state governments had all earlier agreed to administer loans to farmers for debt reconstruction and farm improvement, in cases where there was a reasonable prospect of long-term commercial viability and finance was not available from normal sources.

These moves were not wholly consistent with the longstanding policy of supporting farmers in their existing patterns of production by means of government subsidies and of domestic market prices in excess of export parity. The wool-growing industry, in particular, succeeded during 1971 in obtaining a very large measure of new government support against the effects of the decline in its output prices.

*Prospects and problems**The control of inflation*

It became increasingly evident during 1971 that new policies were needed to deal with the growing problem of wage-push inflation. By November, six months of talks between representatives of the Government and of unions and employers had failed to produce agreement on means of reforming the industrial arbitration machinery to promote greater stability of costs and prices and to reduce the waste incurred through disputes. The unions, in particular, continued to resist all proposals for sanctions against breaches by them of awards and agreements.

In the 1971 national wage case, the unions lodged claims for an increase of \$12.50, or about 22 per cent, in award wage rates, and an increase in the minimum wage from \$46 to \$70 per week. The hearing has been postponed until February 1972.

Meanwhile there was increasing public discussion of methods of reducing the rate of inflation without at the same time causing serious unemployment. After the introduction of emergency measures in the United States, in August 1971, to limit the increase in incomes and prices, a substantial body of opinion in Australia began to press for the adoption of a similar policy. Other measures suggested include tariff reductions, the appreciation of the exchange rate, a stronger policy against restrictive trade practices, including those operated by unions, and differential taxation of enterprises which granted pay increases in excess of a norm.

The most likely prospect for 1972 was one of continued inflation at a rate of between 5 and 7 per cent per annum, and an increase in registered unemployment to between 1.7 and 2.0 per cent of the labour force. Any substantial change in this prospect depended on the Government's developing and applying a new approach to macro-economic management; and the lags inherent in the economy were such that, even on the most optimistic assumptions, significant results could not be expected before 1973.

The recent realignment of the exchange rates of the major industrial countries resulted in a compromise move by the Australian Government. Balancing the precarious position of its primary industries against its strong surplus balance of payments position, it appreciated slightly relative to the United States dollar but devalued substantially in terms of the currency of its major trading partner, Japan.

The decision of the United Kingdom House of Commons in favour of joining the European Economic Community introduced an additional dimension into the prospects for Australian trade and payments.

It had become clear that there was no hope of preserving preferential entry into the British market for Australian rural exports.

On 7 June, Australia became the twenty-third member of the Organization for Economic Co-operation and Development. Although not a major importance in itself, this event could perhaps be regarded as a prelude to more active Australian participation in international economic affairs, especially in the Asian and Pacific region.

British Solomon Islands Protectorate¹*Introduction*

It should be noted that, because the Protectorate is part of the Australian monetary system, there is no balance of payments problem in the conventional sense. Like a region of a national economy, if export receipts or capital flows fall, the level of internal economic activity falls and imports decline. During 1970, the *per capita* GDP at current market prices (including an approximate estimate of gross subsistence product) of the British Solomon Islands Protectorate increased from A\$156 to A\$167. In aggregate terms, monetary GDP increased by A\$2.6 million to A\$15.3 million and gross subsistence product increased by A\$1.1 million to A\$11.9 million. The trade deficit, which persisted throughout the 1960s, continued to grow as a result of increased import demand.

The instability of export prices continues to give concern. Other problems are the rising cost of food imports, the economy's dependence on foreign aid and the shortage of indigenous skilled manpower.

Table II-3-3. BRITISH SOLOMON ISLANDS
PROTECTORATE: MAJOR ECONOMIC INDICATORS
(in million Australian dollar)

	1969	1970 ^a
1. GDP at market prices (monetary sector)	12.7	15.3
2. Gross subsistence product	10.8	11.9
Total GDP (1 + 2)	23.5	27.2
Total GDP <i>per capita</i> (A\$)	156	167
Exports	6.5	7.0
Imports	8.5	10.0

^a Preliminary figures.

¹ This is the first time that the British Solomon Islands Protectorate has been included in the *Economic Survey of Asia and the Far East*.

The Solomons lie just south of the equator, some 1,000 miles northeast of the Australia.

The Protectorate is a British dependency, but in 1970 a constitution was introduced which provides for a Governing Council with an elected majority and requires the High Commissioner to seek its advice on most matters. Further constitutional advance towards independence is expected following a general election in early 1973.

*Recent economic developments**(a) National income*

Preliminary estimates of national income were first prepared by the 1968 IBRD Mission. These have been subsequently revised and updated, and some of the results are shown in table II-3-3. The figures refer to current prices and should be treated with considerable caution. In particular, the figures for gross subsistence product are only rough approximations.

In the last decade, money national income was highly dependent upon external aid. In 1969, it was equal to 41 per cent of the GDP generated in the monetary sector. The main source of income growth has been in the government sector. In the private sector, it is probable that in real terms domestically generated income in a *per capita* basis fell in the period 1960-1969.

Per capita income values do not reveal the large degree of income disparity which exists between non-indigenous and indigenous income earners. In 1969 some 37 per cent of total wages and salaries were received by non-indigenous workers, although they comprised only 7 to 8 per cent of the work force. In the indigenous sector, practically the whole of household money income accrues from sales of copra.

(b) External trade and payments

In 1970, the value of exports reached A\$7.0 million, copra comprising approximately one half and log exports about 40 per cent of total exports. Japan was the major source of export demand, taking over 50 per cent of exports in 1970 and purchasing virtually all of the log exports. Imports were approximately A\$10 million and the balance of trade was in deficit. Imports, which consisted mainly of transport equipment (30 per cent), food (20 per cent) and manufactured goods (18 per cent), were purchased primarily from Australia and the United Kingdom.

(c) Public finance

The main source of government revenue is customs and excise duties which account for nearly one half of local revenue. Export duties have traditionally been imposed upon primary produce, but the Government is currently reviewing its policies in this respect as there is little doubt that these have had an adverse effect on copra exports and investment in the plantation sector. Direct taxation, timber levies and royalties and the sale of stamps to philatelists are also major sources of revenue. There is a recurrent budget deficit which is financed by the United Kingdom

Government by means of a grant-in-aid. In 1970, the grant-in-aid totalled A\$2.3 million; this was reduced to A\$1.9 million in 1971 and will be held at that level in 1972. Recent changes in budgetary procedures make comparative analysis difficult, but 1970 actual figures were as follows:

Recurrent budget 1970

Local revenue	A\$4,568,096
Grant-in-aid	2,314,659
Total revenue	6,882,755
Expenditure	6,872,934

The capital budget, in which expenditure is expected to reach A\$5 million in 1972, is almost entirely financed by United Kingdom development aid.

Current policy issues

In 1971, the sixth five-year plan came into operation. Strong emphasis has been placed upon the development of the economic infrastructure (29 per cent of total expenditure), natural resources development (25 per cent) and education (15 per cent). The main objectives of the plan are the general diversification of the economy and a reduced dependence upon foreign financial assistance, particularly in the public sector.

Particular attention is placed on agriculture and the improvement of transport facilities. Poor marketing and transport facilities have acted as strong disincentives to increased productivity. Agricultural diversification is planned in areas such as cattle and cocoa, so as to move away from the single crop, copra, exports of which remained static at around 25,000 tons per annum during the 1960s.

In the area of mineral development, negotiations between the Government and a Japanese company for the mining of bauxite are now in an advanced stage. Deposits of bauxite are estimated to be in excess of 60 million tons. However, mining may be delayed in view of the world over-production of bauxite which is not expected to be overcome before 1975. For similar reasons delay in commencing nickel extraction is also likely.

The Government is anxious to increase the amount of processing of agricultural and other products that is done within the Protectorate. In agriculture, palm oil and coconuts offer possibilities, and the allocation of forest areas to logging companies now depends upon their agreement to undertake some local processing. The possibilities of processing bauxite into alumina is also being investigated.

In 1969, a manpower survey showed that non-indigenous manpower accounted for over 80 per cent of post-secondary education level manpower. As a result, public expenditure upon education in the current plan period is directed primarily towards the development of secondary and tertiary education.

Economic outlook

As a result of the programme of diversification and development of the Protectorate's natural resources under the sixth plan, the dependence on two export commodities, copra and timber, is expected to fall by the mid-1970s. The trade deficit is also expected to decline in the later 1970s when policies directed towards export expansion and import substitution in basic foodstuffs have their impact. Self-sufficiency in rice production should be achieved in 1972.

Given the very limited opportunities for the expansion of manufacturing, the areas of greatest potential for future development are timber, mineral ore refining and the further processing of agricultural products. At present, developments in these areas depend upon foreign markets and capital. Development of these sectors is essential, however, if the Protectorate is to move away from the vulnerable situation in which it now finds itself.

Burma

Introduction

With the exception of the mining, construction and banking sectors, all major sectors of the economy showed gains in output. In the agriculture sector, programmes for modernization and diversification continued to receive priority of implementation. Activities in the manufacturing sector were centred mainly on the establishment of import-substitution industries and those supporting agriculture, while, in the mining sector, exploration for oil and prospecting for minerals continued. The foreign trade balance and the balance of payments continued to be unfavourable due to the continuing fall in the price of rice, the principal export commodity. A twenty-year long term plan, divided into five four-year plans, was adopted in 1971, with the first four-year plan coming into effect from 1 October 1971.

Major developments in 1970/71

(a) Production trends

Output rose in all sectors except mining, construction and banking. Increases of around 8 per

cent were recorded in the agriculture, livestock and fishery, forestry and trade sectors, while the manufacturing sector recorded an increase of as much as 15 per cent. Gross domestic product in constant (1969/70) prices was K 10,557 million¹ in 1970/71² which was 6.2 per cent higher than in 1969/70. However, due to the increase in population, *per capita* output rose only by 3.9 per cent to K 374 in terms of 1969/70 prices. Due to an import surplus of K 257 million, there was a 6.3 per cent rise in goods and services available for domestic consumption which rose by 9.5 per cent over the previous year. Investment rose by 14.4 per cent between the two years.

During 1970/71, the sown acreage under various crops was 22.34 million compared with 21.76 million in 1969/70. Due to favourable weather as well as to the improvement in techniques of cultivation and the use of fertilizers, output of all major crops increased. Paddy output rose to 8.03 million tons, which was 2.2 per cent over the 1969/70 level of 7.86 million tons. A marked increase in the output of sugarcane was recorded, standing at 1,414 thousand tons compared with 1,291 thousand tons in the previous year. Cash incentives were mainly responsible for the continued increase in output of oilseeds: groundnut production rising by 19.2 per cent and sesamum by 30 per cent. Substantial increases were also recorded for jute, cotton and wheat. Efforts towards modernization and diversification in agriculture continued during 1970/71. Among other developments, the prices of fertilizers were reduced, there was an increase to 10 per cent of the totals in the area planted with high-yielding rice seed varieties, a considerable extension of irrigation facilities occurred, and increased emphasis was placed on the development of improved seed varieties and livestock strains.

Production of timber, both teak and hardwood, rose in 1970/71. Teak production by the State Timber Board was 358 thousand cubic tons, compared with 301 thousand cubic tons in 1969/70, while total hardwood production was 921 thousand cubic tons as against 912 thousand cubic tons in the previous year. Re-afforestation of the dry zone has now been completed. The milling capacity of the State Timber Board was also increased.

Crude oil production was 217 million gallons in 1970/71: 12 million gallons more than in the previous year. The Myanma Oil Corporation's aerial surveys last year indicated the presence of oil deposits

¹ Unless otherwise stated, all prices are in Burmese kyats. In August 1971, 4.81 kyats = US\$1.

² Fiscal year ending 30 September.

under Burma's coastal waters, and a loan of US\$10 million (for a period of 25 years at 3 per cent rate of interest) has been obtained from Japan to carry out more extensive offshore oil exploration. As regards minerals, output of lead, tin, tungsten and coal rose, while that of zinc, copper, antimony declined.

A rise of 4.8 per cent was recorded in the value of output in the manufacturing sector, standing at K 5,670 million in 1970/71 as against K 5,408 million in 1969/70. All groups of industries in the sector showed progress. The mineral-processing group registered the largest increase, with the value of production rising by K 64.3 million from K 362.3 million in 1969/70 to K 426.6 million in 1970/71. There was a slackening in the rate of growth in the value of food manufacture, the major component, but it still registered an increase of K 47.8 million. Substantial increases were also recorded in the value of production of transport vehicles, personal goods, and industrial raw materials. Apparel manufacture recovered from the previous year's setback. Priority is given to industries whose products aid import substitution and support agriculture. Plants and factories under construction during the year under review include an additional fertilizer plant, a cigarette factory, two textile complexes, a cotton-waste spinning plant and two brick factories.

During 1970/71, total installed capacity of the Electricity Supply Board was 196.52 megawatts. Total energy generated was 570 million kWh, an increase of 20 per cent above the 1969/70 level, while power consumption also rose by 20 per cent from 339 million kWh in 1969/70 to 419 million kWh in 1970/71. Approximately 53.8 per cent of the power utilized was by the industrial sector while the rest was mainly for domestic lighting. Construction of the K 28 million multipurpose Moby Dam begun in 1967 is now complete and the reservoir has been collecting water since July 1971.

Expansion in the capacity of the government transport systems resulted in a steady annual increase of around 4.7 per cent in the value of output in the transportation sector.

Progress has continued in the area of public health and education. Of particular note is the work under the Illiteracy Eradication Campaign, which won for Burma the 1971 UNESCO prize for outstanding work in this area.

(b) *Government finance*

Comprehensive government receipts and expenditure in the revised estimates for 1970/71 amounted to K 7,691 million and K 8,351 million, compared

with the 1969/70 actual receipts of K 7,124 million and actual expenditure of K 7,656 million. On the receipts side, revenue from important taxes, such as income, customs and commercial taxes, was, in all cases, below the 1969/70 level. However, higher receipts from public enterprises resulting from their expanding activities more than compensated for the fall in tax receipts. On the expenditure side, there was an increase of K 695 million or 9 per cent between the two fiscal years due partly to an increase in expenditure on public enterprises and partly to an increase in the cost of administration and debt servicing. Public capital expenditure totalled K 868 million, about K 138 million higher than that for 1969/70. The excess of expenditure over revenue amounted to K 660 million: this was financed by external assistance amounting to K 334 million, drawing down of cash balances by K 321 million and people's savings of K 5 million.

1971/72 is the first year of the first four-year economic plan (1971/72 to 1974/75) and the budget for 1971/72 has been drawn up in accordance with the principles laid down in the guidelines approved at the Party Congress in July 1971. Comprehensive government receipts for 1971/72 are estimated at K 8,347 million and expenditure at K 9,023 million. Expected receipts from most of the important taxes are below the 1970/71 levels and the increase in total receipts reflects the expanding activities of public enterprises. On the expenditure side, among other items, general administration expenditure will rise by 5 per cent to K 1,657 million, but there will be a slight decline in debt servicing. Public capital expenditure will rise from K 868 million to K 1,029 million. Of this total, 36.4 per cent will be for manufacturing, 12.0 per cent for transport and communication, 11.2 per cent for mining and 10.1 per cent for agriculture and irrigation and livestock and fisheries. The excess of expenditure over receipts is estimated at K 676 million: this will be financed by foreign assistance totalling K 404 million, people's savings of K 5 million and the drawing down of cash balances by K 267 million.

(c) *Price level*

The general price level which reached its peak in 1968 has since been falling. Food prices and clothing prices in particular have been falling during the last three years. Wages, on the other hand, have remained stable, resulting in a rise in real incomes.

(d) *Foreign trade and balance of payments*

The value of exports for the first nine months of the fiscal year 1970/71 amounted to K 405 million. In view of brisk sales of rice in the second half of

the fiscal year, the volume of rice exports for the whole fiscal year is expected to exceed the previous year's level of 660,000 tons. However, on account of lower export prices received, the value of rice exports in 1970/71 is likely to fall short of the previous year's level. The value of timber exports is expected to exceed the previous year's level of K 114 million, but the increase is likely to be offset by the decline in earnings from export of metals and ores which totalled K 32 million last year. The value of other agricultural products as a whole is likely to remain at the previous year's level of K 89 million, as the gain in animal feed is offset by the decline in the export of pulses.

The export price of rice continued to fall in 1970/71 to half of the previous two years' level, while export prices of other commodities did not show any significant change between the two fiscal years.

Imports are expected to rise from a level of almost K 800 million in 1969/70 to K 880 million in 1970/71 and to rise further in 1971/72 to over K 900 million.

Non-trade receipts, which fell from K 77 million in 1969/70 to about K 65 million in 1970/71, are expected to recover to a level of K 73 million in 1971/72. Non-trade payments, which totalled K 151 million in 1969/70 and about K 160 million in 1970/71, are expected to reach a level of K 124 million in 1971/72.

Outlook for 1971/72

In fiscal year 1971/72, the first year of the first four-year plan, GDP is expected to go up by 5.4 per cent, compared with the planned increase of 8.5 per cent and actual increase of 4.2 per cent in 1969/70, and with the planned increase of 4.8 per cent and actual increase of 6.2 per cent in 1970/71.

While the first four-year plan aims at an average annual rate of increase in *per capita* income of 2.1 per cent, and of *per capita* consumption of 2.2 per cent, the first year of the plan provides for corresponding rates of increase of only 1.6 per cent and 0.6 per cent. This is due to smaller net imports, to smaller reductions in stocks and to increased investment than in the preceding year. Out of a total investment of K 1,395 million or 12.4 per cent of GDP, K 1,026 million or 74 per cent of the total comes from the public sector. This compares with a planned investment of K 907 million and actual investment of K 730 million in 1969/70, and with a planned investment of K 988 million and actual investment of K 368 million in 1970/71.

Public revenue, which includes income tax (35 per cent), custom duties (13 per cent), excise duties (10 per cent), commercial taxes (9 per cent), and land, forest and mining rents (7 per cent), is expected to fall to a level of K 1,439 million in 1971/72 from K 1,504 million in 1970/71. The decline in income tax is due to the fall in public corporation income resulting from the sharp fall in the international price of rice. On the other hand, government non-developmental or current expenditure rose steadily from K 1,728 million in 1969/70 to K 1,836 million in 1970/71 and is expected to increase further to K 1,861 million in 1971/72.

The gap arising from the fall in tax revenue and the increase in public consumption is to be met by the continued increase in the surplus of public enterprises and the substantial increases in foreign assistance. The amount of external assistance rose from K 196 million in 1969/70 to K 334 million in 1970/71 and is expected to rise further to K 405 million in 1971/72.

On the eve of the implementation of the first four-year plan, there were two significant developments in the planning mechanism. The 1970 Co-operatives Scheme was intended to revitalize and expand the role of co-operatives and to improve the general distribution of consumer goods. The balance method continues to be used in over-all planning, but, for medium-term and annual planning, detailed regional plans have also been drawn up for over 300 townships.

Ceylon

Introduction

In Ceylon, the pace of economic activity slackened in 1970, and the production trends in the first seven months of 1971 do not indicate that a revival is at hand. Output of tea, rubber and paddy (in the 1970 *maha* season) are below their previous levels. "The outbreak of insurgent activities and its consequent disruption of almost every sector of the economy in varying degrees"¹ affected Ceylon's economic performance in 1971 and it is officially estimated that GNP will have grown by about 1 per cent in 1971 and will regain its 1970 level in 1972. Ceylon had to mobilize external resources, incurring a significant amount of short-term external liabilities, to finance not only the deficit in the current account but also its debt servicing. In the first half of 1971 it had programmed for a sizable reduction in its current account to achieve a much needed increase

¹ Minister of Finance: *Budget Speech 1971-72*, 10 November 1971, p. 8.

in its foreign exchange reserves. With its economic growth vitally dependent on imports, Ceylon decided in its 1971/72 budget to adopt measures for curtailing consumption and increasing domestic saving.

Recent economic developments

(a) Production trends

At constant prices, the gross national product increased by only 4.1 per cent in 1970, as compared with 7.9 per cent in 1968 and 5.1 per cent in 1969. The output of the manufacturing and construction industries, whose expansion had contributed directly and indirectly to the exceptionally high growth rates of the gross national product in the preceding two years, increased by only 3.6 per cent, as compared with 14.0 per cent in 1968 and 11.3 per cent in 1969. The deceleration of activity in the manufacturing and construction industries was accompanied by a sharp fall in the rate of expansion of the services sector. The output of transport, storage, communications and wholesale and retail trade services increased by only 1.7 per cent, as against 5.6 per cent in 1968 and 9.1 per cent in 1969. Agricultural output, which accounts for over a third of the gross national product, rose by 3.6 per cent in line with the average rate of increase over the past few years. There were, however, significant differences in the rates of growth of different crops. The production of tea, Ceylon's major export, fell by 3.3 per cent, while coconut production was virtually unchanged. The output of rubber increased by 5.4 per cent. In contrast to the poor performance of export crops, impressive growth rates were achieved by crops grown exclusively for domestic consumption. Paddy production increased by 16.5 per cent, while the value of subsidiary foodstuffs also increased by 24.5 per cent.

(b) Balance of payments restraint

Ceylon continued to experience a severe foreign exchange constraint on its development. The structural features of the Ceylon economy are such that its prosperity is closely linked to the availability of imports. In 1970, there was a sharp fall in imports as a result of measures taken by the Government, and the volume of imports of all goods fell by 6 per cent. Much of this contraction was concentrated on imports of raw materials, the volume of which decreased by as much as 17 per cent.

The curtailment of imports afforded some relief to the balance of payments. In 1970, total import payments fell by 12 per cent from Rs 2,655 million to Rs 2,336 million. The balance of payments also benefited from a slight improvement in export earn-

ings. After several years of stagnation, export receipts increased by 5.3 per cent from Rs 1,909 million to Rs 2,011 million. The increase in export proceeds was primarily due to a 4 per cent increase in volume, which was partly achieved by running down stocks. There was only a marginal improvement in export prices, which increased by 0.5 per cent. As a result of these movements, the deficit in the merchandise account amounted only to Rs 325 million, as compared with the record level of Rs 746 million in the previous year. The deficit in the services account increased from Rs 90 million to Rs 128 million, mainly as a result of the increase in interest payments on Ceylon's foreign debt. Consequently, the total deficit on goods and services amounted in 1970 to Rs 453 million, as compared with the deficit of Rs 836 million in 1969.

The state of Ceylon's balance of payments is such that a moderate deficit in the goods and services account puts pressure on it. Ceylon's external reserves stood at the low level of Rs 366.6 million by the end of 1970. At the same time, past borrowings began to pre-empt an increasingly large proportion of Ceylon's foreign exchange resources for debt servicing. In 1970, capital repayments in respect of project aid, commodity aid, suppliers' credit and repurchases from the IMF amounted to Rs 651.7 million. Thus, external resources were required for financing the current deficit of Rs 453 million of goods and services and for meeting the debt payments. Total receipts in the form of grants, project aid and commodity aid, suppliers' credit, drawing from the IMF and Special Drawing Rights amounted to Rs 997.4 million. As a result, short-term borrowings increased to over Rs 200 million.

In the first half of 1971, Ceylon received capital inflow on account of project and commodity aid amounting to Rs 210.3 million, and short-term and suppliers' credit of Rs 386.4 million to meet not only its current account deficit in goods and services but also its external payments on capital amortization, and, to a greater extent, on short-term and suppliers' credit. However, during the period, the deficit on goods and services was reduced to Rs 154.1 million, from Rs 343.8 million in the corresponding period of 1970. With merchandise exports continuing at the same level as in the first half of 1970, the reduction in the current account deficit was mainly through curtailment of merchandise imports: in the first half of 1971, merchandise imports at Rs 1,086.5 million were Rs 173.6 million lower than in the first half of 1970. The programmed reduction in imports led to an increase in foreign exchange reserves which rose from Rs 366.8 million at the end of 1970 to Rs 424.8 million at the end of July 1971.

The reduction in imports was achieved through a change in the Foreign Exchange Entitlement Certificates (FEEC) scheme. In June 1970, the open general licensing system was abandoned and all imports were brought under individual licensing. Imports of raw materials were licensed on a restricted basis depending on the priority assigned to end-products, while, in the case of large allocations, importers were required to obtain deferred payment terms.

Ceylon's main exports had a mixed record during the first seven months of 1971 as compared with the corresponding period in 1970. The volume of tea exports during the first seven months of 1971 was 268.1 million pounds, less by 20.5 million pounds; there was a small rise in the price of tea (one cent per pound) and tea export earnings decreased by Rs 46.1 million during the periods under comparison. In the case of rubber, a decrease in the volume of exports by 21.3 million pounds accompanied by a fall in price by 19 cents per pound resulted in a decrease in export earnings by Rs 61.8 million during the first seven months of 1971. Export receipts from copra, coconut oil and desiccated coconut were higher by Rs 39.0 million, due both to an expansion of 29.2 per cent in their export volume and a rise of 1.9 per cent in their average export price. Attempts were continued to increase export earnings by restricting the supply of tea according to world demand by finer plucking and the alternative use of marginal land, by processing of rubber, by increasing the productivity of coconut trees by use of fertilizers, and by production of substitutes, such as palm oil and ground nut, to meet growing domestic demand. Efforts have been initiated to diversify exports by increased production of cocoa.

The considerable reduction in imports during the first seven months of 1971 was mainly in consumer goods, including food articles and textiles, while raw materials and machinery suffered only a moderate reduction as compared with the corresponding period in 1970. Ceylon's progress in import substitution on the food front received a set-back in 1970: the 1970 *maha* paddy crop amounted to only 41 million bushels as compared with the previous crop of 49.5 million bushels, the major constraints on increased production, apart from adverse weather, being the supply of fertilizers and agricultural credit. Progress in import replacement through increased production of subsidiary food crops, however, was satisfactory.

The balance of payments position has led to the re-shaping of industrial policy. Previously, under the general policy of encouraging import substitutes, several industries were established which were heavily dependent on imported raw materials and which,

in some cases, produced goods considered inessential by the authorities. Since 1970, priority has been given in approving new investments to:

- (i) industries which use a high proportion of indigenous raw materials,
- (ii) industries which produce goods primarily for export,
- (iii) industries to be located in under-developed or non-industrialized parts of the country, and
- (iv) small labour-intensive industrial units.

The desire of the Government to hold down prices of imported goods, in a situation of general import scarcities, has induced the Government to widen state trading activities. Even before 1970, the import of a large number of food items, as well as textiles, had been confined to state institutions. Under the new policy, several state trading corporations have been established to import a variety of consumer and intermediate goods, though a substantial proportion of the trade in imports continues to remain in private hands.

(c) *Fiscal operations*

In view of the balance of payments difficulties, the budget presented in November 1970 aimed at limiting the expansionary impact of fiscal operations as far as possible. Total capital expenditure in the fiscal year ending September 1971 was budgeted at Rs 4,058 million, an increase of 4.4 per cent over the actual amount of expenditure in the previous fiscal year. Revenue was estimated to increase by 5.2 per cent to Rs 2,878 million. The expectation was that the budget deficit of Rs 1,180 million would be financed to the extent of Rs 638 million from foreign aid receipts, and Rs 542 million from internal sources, of which only Rs 97 million was to be raised from the banking system. The revised estimates indicate an increase in the budgetary deficit by Rs 247 million. Insurgent activities resulted in higher security expenditure, and, by retarding the progress of development projects and adversely affecting production in certain areas, contributed to a fall in revenue. There was also a major shortfall in receipts from export duties. The increase in the budgetary deficit was to be covered by external resources equal to Rs 707 million and by borrowing Rs 106 million from the banking system.

Money supply increased by 4.5 per cent during 1970. Its rate of expansion, which was much higher during the first ten months of 1970, was reversed in

November 1970 by the demonetization of higher currency notes. But the major factor determining the money supply, credit expansion in the public sector, has resumed its importance since then, and, in the first half of 1971, the money supply expanded at the rate of 8.5 per cent.

The expansionary effect of fiscal operations, the shortage of imports, and a rise in the prices of imported goods, all combined to exert upward pressure on prices and wages. The Colombo Consumers' Price Index registered an increase of 5.9 points during 1970 and a further increase of 5.1 points in the first eight months of 1971, despite the fact that some of the important items entering into the calculation of this index are either subsidized or subject to price controls.

(d) *Unemployment*

Although accurate data are not available, there are clear indications that the problem of unemployment is beginning to assume serious proportions. In the wake of the population boom of the post-war period, large numbers of young persons are now entering the labour force each year. At the same time, the economy has not been growing in recent years at a pace sufficient to create additional job opportunities on the required scale. That the volume of unemployment is rising sharply, is indicated by the statistics of registrants for employment at labour exchanges. The total number of persons registered as seeking employment (which includes persons who are employed but are looking for better work) increased from 276,000 at the end of 1968 to 411,000 at the end of 1970. A survey conducted in 1969/70 revealed that, in the rural sector, 11.3 per cent of the work force is unemployed. Projects included in the 1970/71 budget to provide accelerated opportunities for employment are generally admitted to have failed to generate the expected increase in employment.

Current outlook

Recent experience demonstrates that the rate of economic growth which Ceylon is able to achieve is closely dependent on the availability of imports. Shortages of managerial and technical skills seem to have been overcome to a great extent, and Ceylon now appears to possess the potential to expand at a rapid rate, provided that the required foreign exchange resources can be found. Unfortunately, prospects for export earnings and foreign aid give little cause for optimism. Ceylon's two major traditional export products, tea and rubber, continue to face weak demand in international markets. Ceylon's other major export, coconut products, has been experiencing favourable prices, but a substantial increase in

export quantities is unlikely to be forthcoming, due to increasing domestic consumption. In 1968 and 1969, a certain buoyancy was observed in minor exports, probably in response to the incentives offered under the Foreign Exchange Entitlement Certificates scheme, but the pace of expansion appears to have slackened. Plans are being undertaken to develop exports of manufactured goods. Their expansion, however, is likely to depend on the free availability of raw materials. Some increase in tourist earnings could be expected, but at present they contribute only a small portion of Ceylon's foreign exchange earnings. Thus, there is no immediate prospect of a substantial increase in exchange earnings.

Unless foreign aid is forthcoming on a substantially larger scale than in the past, there is little prospect of the capital account of the balance of payments being sufficiently strong to finance a sizable import surplus. In the past two years, the amount of foreign aid received by Ceylon has been well short of expectations and the prospects for 1971 are not encouraging. At the same time, Ceylon faces heavy debt repayments during the next few years; in 1972 the scheduled commitments in foreign debt are expected to amount to well over one-third of the total value of exports anticipated in 1972. Unless new sources of aid or debt relief develop, it is probable that, in 1971 and 1972, total aid receipts will not exceed repayments by a significant margin.

The scope for further reduction in consumer imports is limited. Consequently, it is likely that the balance of payments constraint will mainly affect imports of raw materials and possibly also capital goods and this will have adverse effects on growth in the output of the manufacturing and construction industries in 1971. In the case of agriculture, present trends are likely to continue. The output of export crops may register only a marginal increase. On the other hand, non-export crops are likely to grow. The expansion of these crops is favoured by the priority given to imports of fertilizers, the existence of guaranteed price schemes, and, in some cases, the stimulus provided by the high prices resulting from import restrictions.

Faced with a difficult choice between a restriction of consumption expenditure and a low level of investment, which will only compound the problems in the long run, Ceylon has opted for the politically difficult choice of restricting consumption and increasing domestic saving. The budget for 1971/72 aims at a rise in the price of subsidized items of food consumption, an increase in the prices of some public services, a ceiling on disposable incomes and an extension of the compulsory savings scheme by two more years.

Fiji

Introduction

Fiji entered the first year of the 1970-1975 development plan with a rise in the rate of growth of gross domestic product from the low level recorded in 1969. Although exports increased in value, imports continued to rise faster, so that the trade deficit increased. The sharp rise in capital inflow and external aid, and the continued rapid expansion in tourism allowed the balance of payments to remain in over-all surplus. The money supply rose very sharply during 1969 and 1970, and price inflation and the sharp upward movement of wage rates have caused increasing concern during 1971. Measures to bring about greater stability in prices and incomes are currently under consideration.

Recent economic developments

(a) Economic growth and output

Preliminary estimates show that, in 1970, gross domestic product, at constant prices, grew by 4.8 per cent. While this was a substantial improvement on the 1969 growth rate of 1.2 per cent, it was well below the target rate of 6.7 per cent per annum set for the sixth development plan (1970-1975). The sharp recovery of manufacturing output, a higher level of building and construction, and a further increase in tourism were the main features of 1970. Production of sugar, the main agricultural crop, increased to 355,000 tons compared with 300,000 tons in 1969. Because of unfavourable weather conditions, output in 1971 will be only about 335,000 tons.

Preliminary data suggest that, for 1971, gross domestic product at current prices will increase by over 13 per cent. However, as prices are expected to rise by approximately 6.4 per cent during the year, the real increase in gross domestic product will be only about 7 per cent, slightly in excess of the plan target.

(b) Foreign trade and balance of payments

Export receipts in 1970 rose by 8.9 per cent over 1969, largely because of an increase of 13.2 per cent in sugar earnings through higher volume and improved prices. Imports, on the other hand, increased even faster (by 14.4 per cent), so that the trade deficit rose from F\$16.1 million to F\$21 million. On services account, however, there was a surplus of F\$3.5 million, largely because of substantial receipts from tourism (20 per cent higher than in 1969). The current account deficit was thus F\$17.5 million, an increase of F\$2.6 million over that for 1969. Higher

levels of foreign aid, private capital inflow and government external borrowing were more than sufficient to meet this, so that the over-all balance of payments remained in surplus.

In 1971, the trade deficit is expected to rise to about F\$26 million. Export earnings are likely to be substantially higher than in 1970, because of an increase in the volume of sugar exports and the present buoyant prices of this commodity, but imports, especially of capital goods and industrial inputs, are again expected to rise faster. However, data on tourist receipts and capital and aid inflows for the period up to July 1971 suggest that an over-all surplus in the balance of payments will again be achieved. At the same time, the contribution of the services account has not been growing in recent years as fast as the trade deficit: though receipts from tourism have been rising rapidly, payments for transport and insurance, and for debt-servicing have also increased significantly. Freight rates for services between Fiji and Australia and New Zealand, for example, increased by more than 25 per cent in 1971. Thus, in recent years the reliance of Fiji on external aid and capital inflow has increased, a trend which underlines the need for longer-term measures to develop new lines of exports.

A summary of the balance of payments is given in table II-3-4.

(c) Prices, wages and money supply

There are signs of over-heating in the Fiji economy at present. A rise of 3.5 per cent in consumer prices in 1968 was followed by rises of 5.1 per cent in 1969, 4.1 per cent in 1970 and an estimated 6.4 per cent in 1971. There are a number of contributing factors to this trend. With the ratio of imports to gross domestic product at over 50 per cent, Fiji is highly susceptible to rising import prices. Moreover, the excess pressure on the building construction sector has meant that building costs have been rising at over 30 per cent per annum, a trend now being reflected in the upward movements of rents for both commercial buildings and dwellings. Prices of local food items, which are a major element in the consumption pattern of urban workers, have risen in recent months largely because of the sluggish response of local agricultural production to increased demands.

The money supply has grown rapidly since 1968. The growth rates of 8.9 per cent in 1968, 20.6 per cent in 1969 and 20.1 per cent in 1970 are considerably higher than the rates of growth of gross domestic product over the same period. Trading bank advances, especially to the commercial sector, have also

Table II-3-4. FIJI: BALANCE OF PAYMENTS
(REVISED) 1968-1970
(in million Fijian dollars)

	1968	1969	1970
A. <i>Goods and services</i>	-13.3	-14.9	-17.5
Exports, including non-monetary gold (f.o.b.)	43.3	47.3	51.5
Imports (f.o.b.)	55.3	63.4	72.5
<i>Trade balance</i>	-12.0	-16.1	-21.0
Services (net)	-1.3	1.2	3.5
Transportation and insurance	-7.5	-8.1	-8.0
Travel	12.1	16.7	19.9
Investment income	-6.7	-7.8	-9.0
Government n.i.e.*	1.2	1.3	1.4
Other services n.i.e.*	0.3	0.8	0.8
B. <i>Transfer payments and capital (net) (other than group E)</i>	7.8	3.4	15.9
Private transfer payments	0.9	0.9	1.4
Government transfer payments	3.4	5.1	5.7
Private long-term capital (net)	4.7	5.5	6.6
Official capital (net)	0.6	-6.3	5.0
C. <i>Net errors and omissions</i>	5.3	16.5	5.1
D. <i>Over-all balance of payments (A+B+C)</i>	-0.2	5.0	3.5
E. <i>Monetary movements</i>	0.2	-5.0	-3.5
Net balance due from banks abroad	—	-3.6	-2.3
Net change in assets of government enterprises	0.2	-1.4	-1.2

Source: Bureau of Statistics, Fiji.

* n.i.e. = not included elsewhere.

risen sharply. The inflationary impact of this trend and its implications for the balance of payments in an economy in which local services respond to increased demand only with a substantial lag and the spill-over into imports is almost immediate, has been recognized by the Government. For these reasons, the Government is at present reviewing the level and growth of credit with a view to introducing monetary policies designed to control internal demand. The Government also intends to establish shortly a central monetary authority, which will eventually become a fully-fledged central bank.

Average wage rates grew at about 7 per cent per annum between 1965 and 1970, but the trend of wage movements in 1971 has been causing considerable concern to the Government. Wage settlements between unions and employers have provided for increases varying from 15 per cent to 33 per cent, a development which reflects not only the growing strength of trade unionism in Fiji but also the impact of rising prices. The implications of these wage trends for Fiji's rural development programme, urban

unemployment, capital inflow and balance of payments are currently under investigation, and the possibility of setting up a prices and incomes board to establish guidelines related to those outlined in the development plan for prices, wages and other incomes is at present being studied by the Government. As an interim measure, price control of selected essential consumer goods was introduced in April 1971.

(d) *Public finance*

The budget for 1971 provided for an increase of 14.5 per cent in expenditure to F\$45.1 million, about the same percentage rise as in 1970. Revenue from import, export and excise duties was expected to increase, because of a rising level of imports and of the increased excise taxes on motor vehicles, alcohol and tobacco introduced in the 1971 budget. Expenditure in 1971 involved substantial increases in outlays for education, health and general administrative services. The 1972 budget pegged recurrent expenditure at approximately F\$53 million, an increase of

about 14 per cent over 1971. This is higher than the guideline increase of 9 per cent outlined in the development plan, but was occasioned by special outlays for the establishment of overseas missions after independence, as well as increased costs arising from a reorganization of the civil service in July 1971. The capital budget for 1972 provides for outlays of approximately F\$20 million, compared with estimated actual outlay in 1971 of F\$11 million. The latter was short by some F\$3 million of the planned programme for 1971, largely because of pressure on the building and construction industry and shortage of skilled personnel. The same problems are likely to continue into 1972. However, the planned outlay of F\$20 million includes F\$4 million as an advance payment on the Suva-Nadi road as well as the counterpart costs of certain project feasibility studies. Actual expenditure involving the physical capacity of the building and construction industry will be less than F\$16 million which should be feasible especially having regard to the higher prices and costs likely in 1972 compared with 1971. Approximately F\$3.1 million of the 1971 capital works programme was financed by development grants from the United Kingdom Government and through other external borrowing. In 1972, United Kingdom grants of F\$2.1 million are expected, and borrowing from the World Bank and other external sources is expected to be F\$6.4 million.

Prospects for 1972

The main problems likely to be of concern in 1972 include the control of inflation, industrial unrest, the removal of agricultural production bottlenecks, urban unemployment, the shortage of skilled manpower and the continuing pressure on the building and construction industry. Policies to deal with all of these issues are currently being formulated. Special crash programmes to increase the supply of skilled workers, especially in building and construction, are expected to begin to take effect from about mid-1972, but measures for the longer-term provision of skilled manpower are also under consideration. A detailed review of industrial relations is being undertaken and it is hoped that this will lead to improvements in the present machinery for negotiating wages and working conditions, having regard, in particular, to the productivity-related guidelines outlined in the development plan. A committee to study inflation has already reported to the Government with recommendations on monetary and fiscal policies, agricultural production, productivity schemes, and prices and incomes policies. The report is still under study by the Government but it is expected that the sections of the report which it accepts will be implemented in 1972.

Improvements in the marketing of local agricultural produce are expected to flow from the recently established National Marketing Authority, which will buy agricultural produce from the outlying areas and market it in areas where the population is concentrated. It is hoped that the improvement of marketing will remove an important deterrent to increased production. A major concern in 1972 will be the preparations for the transfer to the Government in April 1973 of the ownership of the South Pacific Sugar Mills Limited (SPSM), the sole processor of cane sugar in the country. Assistance in planning for the take-over is being given by the Commonwealth Secretariat and an agreement between the Government and the Colonial Sugar Refining Company (which owns SPSM) has been signed which provides, *inter alia*, for continued assistance after April 1973 in marketing, management and research.

The changes in the world gold price is of major interest to Fiji, as gold exports provide approximately F\$3.5 million a year in export earnings. Gold mining has been in some difficulty in recent years because of rising costs in the face of a fixed price for the product. A rise in the price of gold would therefore help to maintain in existence an industry which is not only an important contributor to the balance of payments but is also a major employer of labour in the country.

Hong Kong

Introduction

The Hong Kong economy experienced another successful year in 1970. Exports increased substantially, but inflation caused concern with the consumer price index increasing by approximately 7.6 per cent in 1970. In the first half of 1971, however, it remained remarkably steady. Business conditions have remained buoyant, and Hong Kong continues to attract foreign investment.

Recent economic developments

There is no official figure for *per capita* income in Hong Kong, but unofficial estimates¹ suggest that it has grown between 9 and 10 per cent annually in real terms over the past decade and that by 1970 it was approximately US\$700, which would place Hong Kong equal or second to Singapore among ECAFE developing countries as far as *per capita* income is concerned.

¹ See Glassburner, B., and Riedel, J., "Government in the Economy of Hong Kong", *Economic Record*, forthcoming, or Annual Yearbook, 1971, Far Eastern Economic Review, Hong Kong, 1971.

(a) Trade

In 1970, domestic exports (as distinct from re-exports), of which 96 per cent were manufactured merchandise, amounted to HK\$12,347 million. This represented an increase of 17.4 per cent over domestic exports in 1969, but was less than the rates of growth of 24.6 per cent and 25.8 per cent per annum recorded in 1969 and 1968 respectively. Hong Kong's exceptional export growth in 1969 and 1968 was due in part to the expansion of world trade in those years. However, the attempt of the industrialized countries to stem inflation in 1970 produced a downturn in aggregate demand and resulted in a lower rate of growth of Hong Kong exports. The increases in domestic exports for the first and second quarters of 1971 were 10.3 and 14.7 per cent, respectively, over those of the corresponding quarters of the previous year.

The non-cotton textile agreement signed with the United States will adversely affect the textile industry. Clothing, which has also been subject to other trade restrictions, has in the past maintained about a 35 per cent share of exports by shifting to higher-quality goods with greater value added per item, and to non-cotton garments which have been relatively free of trade restriction. In 1970, woollen and man-made fabrics accounted for almost 37 per cent of total clothing exports (13 per cent of total domestic exports). Of this amount, over 40 per cent was exported to the United States. The effect of limiting the growth of non-cotton textile exports to the United States to 7.5 per cent per annum will be adversely felt throughout the economy.

Entrepot trade, once the life blood of the economy, has steadily decreased in importance. In 1970, re-exports accounted for only 19 per cent of total exports, down from 23 per cent in 1965 and from perhaps as high as 75 per cent in 1953. Fifty per cent of all re-exports are consumer goods, for the most part originating in the People's Republic of China (24 per cent), the United States (17 per cent) and Japan (10 per cent). With the likely increase in global trade of the People's Republic of China, the importance of entrepot trade may be further eroded.

Imports, like exports, have grown and reached HK\$17,607 million in 1970. Their growth is closely correlated to exports, because the raw materials and physical capital inputs for manufacture, which are largely supplied from abroad, account for more than 50 per cent of total imports. Consumers also rely on imports for approximately 80 per cent of their food needs.

Hong Kong usually has a balance of trade deficit, and, in 1970, imports exceeded exports by HK\$2,369

million. However, the fact that the Hong Kong dollar remains stable and bank reserves continue to mount indicates that Hong Kong's visible trade deficit is more than offset by invisible earnings and capital inflow. Tourism no doubt accounts for a significant proportion of these. Hong Kong has also benefited from a large and sustained capital inflow attracted by the colony's political and economic stability. It is estimated that 50 per cent of domestic bank deposits are held by non-residents.²

(b) Wages and prices

In 1970, an acute labour shortage faced the colony. According to the Labour Department, 24,984 vacancies were reported as of March 1970 by industrial establishments registered with the Department.³ This was an increase of 47 per cent over the number reported in the previous year. This condition was naturally led to rising wages for industrial workers. Between March 1970 and March 1971 wages increased by 18 per cent in nominal terms and 9.2 per cent in real terms, bringing the over-all average daily wage of industrial workers, excluding fringe benefits, to over US\$3.

Rapid economic expansion and full employment, accompanied by rising wages, have had an inflationary impact on the economy. In the period 1964-1970 the consumer price index (CPI) has increased at an annual compound rate of 4.2 per cent. In 1970, monthly average consumer prices were 7.6 per cent higher than in 1969. This was the largest annual increase in prices in the colony's recent history. Food-stuffs, which constitute a large share of consumer expenditures (48.3 per cent according to CPI weights) and are largely imported, were a major source of the increase.

(c) Money stock

The price and exchange rate stability which characterized the decade of the 1960s, and the accelerated rate of growth of the money stock in recent years can be explained in part by the workings of Hong Kong's unusual monetary mechanism. Currency is issued almost wholly by private commercial banking institutions against 100 per cent sterling reserves. The 18.2 per cent average per annum growth of the money stock between 1967 and 1970, which contributed to inflation, was a direct consequence of the export boom working through the automatic monetary mechanism.

² *Annual Yearbook, 1971*, Far Eastern Economic Review, Hong Kong, 1971.

³ *Annual Labour Department Report, 1969-1970 and 1968-1969*, Government Printer, Hong Kong, 1970, 1969.

*Economic policy in 1970/71**(a) Monetary policy*

The Government rarely uses monetary policy to influence the level or composition of aggregate demand, although by shifting liquid assets into and out of the banking system, it can manipulate bank reserves. Besides, given the highly liquid position of the commercial banks, with liquidity ratios of about 35 to 40 per cent, marginal adjustments by the Government would have little or no effect.⁴ It does not appear that the Government is likely to use monetary policy measures in the near future.

(b) Fiscal policy

In 1970/71, public expenditure amounted to only 14 per cent of estimated GDP — well below the proportion of government expenditure for countries at a comparable level of development. Moreover, the inability to forecast revenue, due to the openness of the economy, and the time lag inherent in capital expenditure have resulted in extremely large budgetary surpluses in the last few years. For the fiscal year 1970/71, revenue exceeded expenditure by an amount equal to 25 per cent of total expenditure, despite an annual increase in expenditure of almost 26 per cent.

Compensatory fiscal policy aimed at regulating aggregate demand in order to maintain stability has never been used by the Hong Kong Government. Expenditure decisions are made to maintain an orderly expansion of public facilities. Further, it is believed that, because of the openness of the economy, with an average propensity to import of around .60-.70, leakages in the income stream would be so great as to make such a fiscal policy ineffective.

However, it must be noted that, even within these limitations, the budgetary surplus in 1970, because of its magnitude, did exert compensatory pressure on the inflationary economy.

Problems and prospects for the economy in 1971/72

In spite of the fact that Hong Kong is exposed to the fluctuations of international trade, the colony has grown rapidly and steadily. This high degree of stability has been largely due to the foresight and ability of entrepreneurs to diversify production to meet changing market conditions. By minimizing investment in specialized capital, land and buildings, Hong Kong manufacturers maintain a high degree of flexibility.

⁴ The liquidity ratio is defined as the ratio of the sum of (i) cash, (ii) net balances due from other banks and (iii) short-term (3-month) Treasury Bills and guaranteed government loans to deposit liabilities. The legal liquidity ratio is 25 per cent.

(a) Commercial policy

In 1971, however, Hong Kong has faced a great deal of uncertainty arising from the United States' trade moves, which could impair the growth of Hong Kong's largest market, and from the United Kingdom's entry into the European Economic Community, which will eliminate Hong Kong's long-enjoyed Commonwealth preference. The European Community, along with the United Kingdom, has accepted the colony as a "developing" nation for purposes of the UNCTAD generalized preference scheme, but this move will not completely compensate for the loss of Commonwealth preference, as the EEC offer was not extended to the textile and footwear industries. In addition, the EEC reserves the right to restrict so-called "sensitive" products from the scheme and these may include many of Hong Kong's exports.

The non-cotton textile agreement concluded with the United States will have a severe effect on the economy. It has already been predicted that Hong Kong may lose as much as HK\$500 million in potential export earnings as a result of the agreement.⁵

The most immediate domestic problem is the shortage of labour, especially skilled labour. At present facilities are inadequate to supply the current demand for technical labour. The Government is responding to this problem: a new technical institute was opened in 1970 and two similar institutions are being planned, but projects of this nature inherently have a long gestation period and, for this reason, growth in the short-term may be frustrated by this shortage.

Hong Kong manufacturers have relied almost exclusively on retained earnings and personal resources to finance investment in fixed capital.⁶ There are no investment banking facilities available to small-scale manufacturers in Hong Kong, and commercial banks, while willing to provide working capital, have strictly adhered to conservative banking principles, avoiding long-term loans. As profits of manufacturers are squeezed by rising labour and land costs, more access to an organized capital market will be necessary to maintain investment. Therefore, as has been recommended by a committee of the Trade and Industry Advisory Board, government participation in the establishment of medium- to long-term credit facilities for small-scale industry may be necessary in the near future.

⁵ *South China Morning Post*, Hong Kong, 16 October 1971.

⁶ According to the unpublished "Report of the Loans for Small-Scale Industry Committee to the Trade and Industry Advisory Board", 89 per cent of fixed capital investment of small firms came from their own resources; only 2 per cent came from commercial banks.

India

Introduction

In 1970-71, India's national income at 1968-69 prices is estimated to have risen by 4.8 per cent, as compared with 5.3 per cent in 1969-70; for the two-year period (1969-70-1970-71), the average annual compound rate of growth amounted to 5 per cent, as compared with the fourth plan target of 5.6 per cent. The growth was achieved mainly because of a 5.3 per cent rise in agricultural production, and foodgrains output is estimated to have reached 107.8 million tons in 1970-71, or an 8.3 per cent rise over the previous year, with a perceptible increase for the first time in rice production from 40.43 to 42.45 million tons.

However, the growth rate of mining and manufacturing (in terms of net value added) was 3.2 per cent in 1970-71, as compared with 5 per cent in 1969-70 and 7.7 per cent target in the fourth plan. Wholesale prices rose by 4.6 per cent in 1970-71, as compared with a rise of 5.5 per cent in 1969-70.

The trade deficit fell from Rs 1.7 billion to Rs 0.9 billion in 1970-71, exports rising by 8.6 per cent, and imports by 2.7 per cent. In 1970-71, authorizations of external assistance rose by 18 per cent, in contrast to the 25 per cent decline in the previous year, but actual availability in 1971 is presently subject to considerable uncertainty.

Table II-3-5. INDIA: SELECTED ECONOMIC INDICATORS

	1968-70		
Net national product at factor cost (billions of rupees, 1968-69 prices)	301.31	315.69	4.8
Index of agricultural production (1949-1950 = 100)	170.80	182.20	6.5
Output of foodgrains . . . (million tons)	99.50	107.81	8.3
Index of industrial production (1960 = 100)	172.50	180.30	4.5
Index of wholesale prices . . (1961/62 = 100)	171.60	181.10	5.5
Money supply (Rs billion) . .	63.87	71.57	11.8
Bank credit (Rs billion) . .	39.71	46.60	17.3
Bank deposits	50.28	58.96	17.3
Exports (Rs billion)	14.13	15.35	8.6
Imports (Rs billion)	15.52	16.25	2.7

Source: Various official publications.

During the period 1968-69 to 1970-71, the ratio of net investment to national domestic product at current prices was about 9.5 per cent, as compared with 13.4 per cent in 1965-66. Two of the major factors that have restrained the growth in investment have been the drop in net external resource flows and increased public consumption. The budgetary position in 1970-71 has been marked by a larger deficit than expected, leading to a considerable increase in money supply. The pressure of the increased fiscal burden continued during the current year as a result of a massive increase in government expenditure which the country had to bear for the relief and maintenance of refugees and for defence purposes. The over-all budget deficit is thus likely to be considerably higher than the original estimate of Rs 3.87 billion.

Recent economic developments

(a) Agriculture

In the agricultural year 1970-71, foodgrains output reached a record of 107.8 million tons, as against the fourth plan target for the year of 106 million tons. In recent years, under the impact of the New Agricultural Strategy, the area under high yielding varieties of seeds, particularly wheat and rice, has expanded considerably. However, in terms of output, only in the case of wheat has there been a clear break from past trends.

The New Strategy, making greater use of fertilizers and controlled water supplies, has made rapid strides in terms of area under high-yielding varieties. Consumption of nitrogenous fertilizers (in terms of nitrogen) increased by nearly 5 per cent in 1970-71 over the previous year to reach a level of 1.43 million tons as compared with the plan target of 1.73 million tons. Phosphatic and potassic fertilizers recorded an increase of about 10 per cent.

Only a few cereal crops have significantly benefited so far from the strategy. Output of pulses, which are the major sources of protein for the Indian population, has stagnated. There are as yet no signs of a seed fertilizer output revolution in the case of major cash crops, including jute, cotton and oilseeds. As against fourth plan targets for 1970-71 of 6.5 and 6.7 million bales of cotton and jute, the outputs were 4.5 and 4.9 million bales respectively. These are very important raw materials from the point of view of domestic consumption as well as exports.

(b) Industry

The rate of growth of the index of industrial production dropped from 7.1 per cent in 1969 to 4.5

per cent in 1970, and the index has shown even slower growth during the first six months of 1971. Over-all industrial performance, therefore, has been well below the target of 8-10 per cent per annum set for the fourth plan.

The performance of different groups of industries is available at the time of writing only up to the end of 1970. This is shown in table II-3-6. Except for capital goods industries, all groups of industries showed a decline in their rate of growth in 1970, the decline being substantial in the case of basic industries and consumer durables.

An important reason for the slow-down in industrial growth was the shortage of raw materials, such as steel, cotton and jute. The somewhat stagnant picture regarding domestic production of cotton and jute has already been touched upon. In the case of steel, because of a number of problems, including labour troubles and inadequate plant maintenance, finished steel output declined from 4.94 million tons in 1969/70 to 4.70 million tons in 1970/71, as compared with a target of 5.70 million tons. The capacity remained at 6.9 million tons. However, imports of steel were substantially higher in 1970/71 at Rs 1,471 million as against Rs 815 million in 1969/70.

It has been stated that capacity limitations affected output in some industries, such as paper, automobile tyres and tubes, tractors and cement, while lack of demand has been the cause of slow growth in the case of other industries, such as machine tools, textile machinery and railway wagons. While this could indeed be the case, it is not easy to determine whether demand or capacity has been the constraining factor, let alone to quantify the significance of the constraint. Perhaps the index of industrial production and its weights do not fully reflect the realities of the industrial structure at present. Further,

there are indications pointing to a more satisfactory output performance in the sector of small-scale industries. Even so, there is no doubt the growth of industrial output in 1971/72 has slowed down.

(c) Public finance

In 1970/71, over-all receipts (including revenue and capital accounts) of the Central and State Governments amounted to Rs 85.79 billion (revised estimate), representing a rise of 4.9 per cent over the 1969/70 level. Tax receipts increased by 12.4 per cent to Rs 47 billion, of which fresh taxation measures were estimated to have yielded Rs 2.15 billion. Aggregate disbursements in 1970/71 were 10 per cent larger than 1969/70, as against an anticipated rise of 4.6 per cent, and the revised estimate of the over-all deficit in 1970/71 was Rs 4.55 billion, compared with the budget estimate of Rs 3.61 billion.

Because of the mid-term elections to Parliament in March 1971, the budget proposals of the Central Government for 1971/72 were not presented to Parliament until May 1971. The budget had to include a tentative provision of Rs 0.6 billion for refugee relief, and, in August, a further provision of Rs 2 billion had to be made on account of refugees coming to India. According to available estimates, after taking into account the inadequate international aid provided for this purpose, the net fiscal expenditure by India on refugees for 1971/72 is estimated by the Government to be of the order of Rs 4 to 5 billion.

Total receipts of the Centre and States at Rs 94.36 billion are budgeted to rise by 10 per cent in 1971/72 over the revised estimates for 1970/71. With total disbursements placed at Rs 98.23 billion, the over-all budget deficit in 1971/72 is estimated at Rs 3.87 billion. The actual deficit, however, as observed at the outset, is likely to be considerably higher.

Table II-3-6. INDIA: INDICES OF INDUSTRIAL PRODUCTION

(1960 = 100)

	Weight	1968	1969	1970	Percentage change	
					(4) over (3)	(5) over (4)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
General index	100.00	161.1	172.5	180.3	7.1	4.5
Basic industries	25.11	194.6	212.0	220.8	8.9	4.2
Capital goods	11.76	210.3	214.0	224.1	1.8	4.7
Intermediate goods	25.88	148.2	154.4	158.6	4.2	2.7
Consumer goods	37.25	131.9	145.3	154.4	10.2	6.3
(a) Non-durables	31.57	117.4	128.3	137.7	9.3	7.3
(b) Durables	5.68	212.4	239.7	247.3	12.9	3.2

Source: Central Statistical Organization, Reserve Bank of India.

(d) Prices and money supply

The upward trend in prices, that resumed in late 1969 after a short break, continued in 1970/71. The wholesale price index increased by 5.5 per cent over the previous year. This trend continued in 1971/72, the index reaching 191.4 in the last week of September 1971, compared with 183.0 in the corresponding week of 1970. Prices increased in all the major commodity groups, with prices of manufactures registering the greatest increase (8.6 per cent) in the period up to September 1971. Thus, during the first half of the fourth five-year plan period the expectations of price stability could not be realized. An important development in price policy was the establishment of the Bureau of Industrial Costs and Prices for review of the cost structure of industries referred to it for study.

Money supply with the public increased by 11.8 per cent in 1970/71 over the previous year, as compared with a rise of 15.0 per cent in 1969/70. The bulk of the increase in money supply in 1970/71, as in 1969/70, was due to an increase in net bank credit to the Government and this reflects the growing imbalance in the budgetary position of the Government, both at the Central and State levels. Bank credit (extended by all scheduled commercial banks) expanded by 17.3 per cent in 1970/71 over 1969/70, with a substantial expansion in credit extended to the small-scale sector, exporters and farmers. The growth in aggregate deposits with commercial banks was 17.3 per cent in 1970/71, as compared with 15.9 per cent in 1969/70.

(e) Foreign trade and external assistance

After a rise of 4 per cent in 1969/70, exports, at Rs 15.35 billion grew by 8.6 per cent in 1970/71. However, the growth over the two years, at little over 6 per cent per annum, is somewhat below the fourth plan target of 7 per cent. Major items of exports that recorded significant increases in 1970/71 over the previous year were oil cakes (33.6 per cent), engineering goods (30.1 per cent), and iron ore (23.9 per cent). Items that recorded significant decreases were leather and leather manufactures including footwear (-11.5 per cent), and cashew kernels (-9.3 per cent).

Imports in 1970/71, at Rs 16.25 billion, were higher by 2.7 per cent than in the previous year; this contrasted with a decline of nearly 18 per cent in 1969/70 from the 1968/69 level. The major items of imports recording an increase in 1970/71 over the previous year were iron and steel (80.5 per cent) and non-ferrous metals (60.5 per cent), while imports of foodgrains (-18.4 per cent) and finished and crude fertilizers (-14.3 per cent) declined.

In the fiscal year 1970/71, authorizations of external assistance totalled \$981 million, indicating a rise of 18 per cent in contrast to the fall of 25 per cent in the preceding year. The amount of assistance that could be made use of during 1970/71 fell, by 3 per cent, to \$1,000 million, mainly due to the tapering off of PL 480 commodity imports. As in the previous two years, loans predominated over grants. Total debt relief assistance (either in the form of fresh refinancing of credit, postponement of payments due, rescheduling of debt or cancellation/reduction of interest) authorized during 1970/71 amounted to \$88 million, \$23 million lower than in the previous year, according to the annual report of the Reserve Bank of India. Total external debt outstanding at the beginning of 1970/71 (including the amount undisbursed) stood at \$8,194 million, and the ratio of debt service to export earnings rose from 29 per cent in 1969/70 to over 30 per cent in 1970/71.

Current policy problem

A major problem is the slow increase in domestic savings and in the real volume of investment in both the public and private sectors. In the public sector, the budgeted outlay in 1971/72 is Rs 31.59 billion, a total which exceeds the corresponding provision in the 1970/71 budgets by Rs 3.37 billion and the likely actual level of expenditure in 1970/71 by Rs 3.36 billion.

Although the above data suggest that the plan outlays in 1970/71 and 1971/72 are roughly 20 per cent of and hence consistent with the outlay for the fourth plan as a whole of Rs 159.12 billion, it must be recalled that fourth plan provisions were calculated at 1968/69 prices, while the figures for 1970/71 and 1971/72 are at *current prices*. Since wholesale prices have risen by over 10 per cent during this period, the real content of the outlays in 1970/71 and 1971/72 may have been less than what was planned for these years at the time of the formulation of the fourth plan. Indeed real investment, which is slowly recovering, is still to reach the level of 1965/66 as the following figures indicate.

The fall in investment since 1965/66, unemployment and the slow-down in industrial growth are causing increasing concern. It should be recalled that 1965/66 and 1966/67 were unprecedented drought years for Indian agriculture, and, partly because of this, 1966-1968 was a period of recession for Indian industry. The sharp fall in domestic savings and investment during 1966/67 and 1967/68, especially as ratios to national income, should be viewed in this context.

Table II-3-7. INDIA: RATE OF INVESTMENT AND SAVING 1960/61 to 1970/71

(percentage of NDP at current prices)

	<i>Investment</i>	<i>Domestic savings</i>	<i>Foreign savings</i>
1960/61	12.0	8.9	3.1
1961/62	10.8	8.6	2.2
1962/63	12.0	9.6	2.4
1963/64	12.7	10.7	2.0
1964/65	12.0	9.8	2.2
1965/66	13.4	11.1	2.3
1966/67	12.2	9.0	3.2
1967/68	10.6	7.9	2.7
1968/69	9.5	8.4	1.1
1969/70	9.2	8.4	0.8
1970/71	9.8	8.3	1.5

Source: Planning Commission, Government of India, *The Fourth Plan Mid-Term Appraisal*, December 1971.

In part, in an attempt to raise the level of savings, fresh taxation measures were introduced in 1970/71, including an increase in direct taxes on larger incomes. As an encouragement to private savings, income up to Rs 3,000 from a wide variety of financial investments was exempted from tax. Further tax proposals of the Centre, estimated to yield Rs 2.05 billion, were introduced in 1971/72. These proposals were also framed with a view to minimizing opportunities for evasion and reducing inequalities in income and wealth. State governments' tax changes are estimated to yield Rs 0.45 billion. From mid-November 1971, further temporary levies were imposed, estimated to yield Rs 0.7 billion, in view of the increasing fiscal deficits referred to in (c) above. In mid-December 1971, a supplementary budget was presented, proposing new taxes to yield Rs 400 million in the remaining part of the current financial year and Rs 1.35 billion in a full year. The fiscal picture and the resources availability have become more complex in the wake of developments on the sub-continent during the major part of 1971 which will continue to present problems in 1972.

Clearly, Indian agriculture has recorded in recent years the beginning of a "green revolution", and, with continued effort in research and investments, the prospect is one of definite promise. There are as yet no signs of a breakthrough in the case of major cash crops, including jute, cotton, and oilseeds and pulses. So far, the possibilities with regard to such crops, particularly cotton, seem to be encouraging on the basis of research done and the use of new varieties (as yet on a limited scale) in the fields.

At the same time, one can already see problems emerging that need to be attended to. In so far as the success of the new strategy in agriculture depends on the availability of water and credit for the purchase of chemical inputs, those farmers whose holdings are not irrigated but are dependent on scanty and uncertain rainfall, as well as those farmers with small holdings, do not gain substantially. Indeed the richer farmers seem to be reaping a disproportionate share of the benefits of the society's investment in the new strategy. Agricultural income taxation, which comes under the jurisdiction of the state governments, has so far been limited, and this question is receiving the attention of the policy-makers.

A beginning has also been made on tackling the problem of the small and dry farms with the establishment of a Small Farmers Development Agency and the initiation of pilot projects under dry land farming. Considerable progress has been made in rural electrification whereby pump sets for irrigation can be energized. This is of particular help to small farmers.

The nationalized banks are continuing to open new offices in relatively "unbanked" areas and the credit needs of smaller borrowers are receiving increased attention. In a general effort to improve credit facilities, a Credit Guarantee Corporation has been established to administer a comprehensive credit guarantee scheme for loans to small borrowers. Under the Lead Bank Scheme, all the districts of the country, except certain metropolitan areas and Union Territories, have been allotted to the public sector banks and two banks in the private sector. This scheme is intended to help identify the problems in deposit accumulation and credit expansion and thereby develop a co-ordinated programme of credit development.

Important changes in trade policy were introduced in 1970/71. An Export Policy Resolution, which was placed before Parliament on 30 July 1970, emphasized the need for sustained growth of exports and outlined a number of measures to achieve this aim. A number of export duties, including the duty on tea, were removed or reduced. Relaxation of industrial licensing procedures was made to create capacity for export production. Larger allocations of imports were made to units in the large-scale sector exporting more than a quarter of their output. Imports of a number of commodities, including iron and steel and raw cotton, were channelled through various public sector agencies.

The current year has been one of trial and tremendous strain for the Indian economy. The fiscal out-turn for 1971/72 will be different, with a much

larger deficit, from what was initially envisaged when the Government took office after the elections. With the consequent rise in money supply, and also with the subdued growth in industrial output, prices have continued to rise, though food production has been satisfactory. The preliminary estimate of foodgrains output in 1971/72 is 112-113 million tons. Even so, a further price upsurge may occur in 1972, unless effective steps are taken in fiscal and monetary fields, as well as in other policy areas. The prospect of external assistance has also become more uncertain, even if it should prove temporary. Under such conditions, the prospect of continued satisfactory food output and the size of the buffer stock are helpful factors making for economic stability. If urgent measures are taken to utilize existing industrial capacity more fully and thereby improve the growth rate of industrial output, the development process will not be seriously impaired. Yet another area where the gains of recent years must be consolidated is that of exports, especially in view of the decline in *net* external resources flows. Efforts to stimulate and mobilize savings in the economy are of paramount importance.

Indonesia

Introduction

The years 1970 and 1971 have been characterized by accelerated development, while, at the same time, price stability has been maintained. Gross domestic product grew by an estimated 6.3 per cent in 1969, by 6.9 per cent in 1970, and an even higher rate is expected for 1971.

On the other hand, though exports were buoyant through 1970 and the early part of 1971, recessionary conditions in a number of developed economies which constitute the major markets for Indonesia began to have an adverse effect on non-oil exports in subsequent months. The desire to maintain export growth in the face of the unsettled condition of the international economy following the measures announced by the United States Government on 15 August 1971, and the need to apply additional checks on imports prompted the Indonesian Government to adjust the rupiah exchange rate by 9.5 per cent, from Rp. 378 = US\$1 to Rp. 415 = US\$1.

In the public sector, although expenditure increased substantially in 1970/71, this was more than matched by increased revenue, arising in part from changes in taxation and, in particular, from substantial improvements in tax collection and administration. Agricultural output continued to expand, and, in manufacturing, the sharp rise in production in

1970 continued in 1971. The rate of price inflation slowed down markedly in 1970 and had virtually halted by mid-1971.

Table II-3-8. INDONESIA: MAIN ECONOMIC INDICATORS

	1969	1970 (calendar years)	1971
GDP growth rate (%) . . .	6.3	6.9	—
Exports f.o.b. (US\$ million) .	995	1,039 ^a	1,204 ^a
Imports f.o.b. (US\$ million) .	993	1,071 ^a	1,207 ^a
Consumer price index (Djakarta, September 1966 = 100, end of period)	575	626	625 (Oct.)
Money supply change (%) (currency and demand deposits)	+58.0	+33.9	+27.8 (Oct.)

^a Fiscal year ended March.

Recent economic developments

(a) Output and growth

The economic expansion which began in 1968 continued throughout 1969 and 1970, with an estimated growth in GDP at constant prices of 6.9 per cent, compared with 6.3 per cent in 1969. A general rise in agricultural output, especially of food-crops, resulted from the sharp increase in rice production to an estimated 12 million tons, an increase of 12.7 per cent on 1969 production. This was largely due to favourable weather conditions and to an increase of 22 per cent in the area planted with new seed varieties under official programmes.

There was some increase also in the production of exportable produce — rubber, palm oil, tea, coconuts and kapok — but a significant decrease in the output of tobacco from small holdings and of pepper.

There is no index of industrial production, but partial data indicate a rapid rate of expansion over a wide range of manufacturing industries in 1970. Cloth production increased by 33 per cent in 1970 and yarn output by 29 per cent. Although production figures for 1971 are not yet available, general indications are that the production of most manufactured goods has continued to rise rapidly.

Production of crumb rubber, which commenced only in 1968, increased from 9,000 tons in 1969 to 35,000 tons in 1970. Output in 1971 will be about 100,000 tons. Paper production is estimated to have increased by 23 per cent, cement by 6 per cent to 577,000 tons, and fertilizer by 13 per cent to 95,000 tons in 1970. There was also an increase in the rate of both domestic and foreign investment in the manufacturing sector, and this should contribute to continued growth in manufacturing output in 1971.

Mining output increased considerably in 1970, with petroleum production up by 15 per cent to 311.6 million barrels. Output from offshore fields is expected to show a further increase of 9 per cent in 1970/71, and, in addition, recently-discovered offshore oil fields were expected to start producing commercially in the second half of 1971.

Tin output increased by 9 per cent to 19,100 tons, while bauxite production is estimated to have increased by 32.6 per cent to 1,229,200 tons. Nickel ore production is estimated to have more than doubled in 1970 to 538,000 tons, mainly in response to increased Japanese demand for low-grade nickel ore. The potential production capacity is currently about 800,000 tons per annum.

Preliminary estimates show that, in 1970, the production of forestry products increased by 26.2 per cent to 9.5 million cubic metres of roundwood equivalent. This increase has largely resulted from new foreign and domestic investment in forestry during the past few years.

As a means of assisting domestic industries, import duties on 76 items, including pharmaceuticals and household appliances, were raised on 1 June 1971. At the same time, duties on 262 other items were lowered in an attempt to deal with smuggling, and this measure was extended to a further 459 items on 1 September 1971. The items included were, generally speaking, of classes not made domestically.

(b) Balance of payments

The value of non-oil exports for the fiscal year 1970/71¹ reached a record level of US\$761 million, an increase of 15.5 per cent over 1969/70. Oil exports increased by 19.2 per cent. Total exports thus rose from US\$1,039 million in 1969/70 to US\$1,204 million in 1970/71, an increase of 15.9 per cent.

The increase in the value of export earnings has been achieved in spite of a tendency for world prices of agricultural commodities exported by Indonesia, especially rubber, to decrease. Fortunately, the significant reduction in rubber exports has been compensated for by increases in export earnings from timber and oil. The increase in the value of exports of oil reflects an increase in volume, while the substantial rise in receipts from timber reflects not only increased volume but also high export prices.

The value of exports of traditional commodities in the first half of 1971 was only 0.7 per cent greater than in the same period of 1970, mainly because of falling export prices. Rubber, copra, coffee and tin

receipts were all lower but were offset by increased receipts from a higher volume of tobacco, palm oil and pepper exports. The sharp increase in the volume of non-traditional exports, such as timber, meant that total non-oil exports were 21.5 per cent greater than in the first half of 1970.

Government policy on imports is designed to foster development activities and, at the same time, maintain economic stability. This has materialized in higher imports of raw materials and capital goods, such as fertilizers, cotton, machinery and heavy equipment, on the one hand, and imports of food (wheat, flour) through aid programmes, on the other.

In 1970/71, total imports amounted to US\$1,207 million, an increase of 12.7 per cent by comparison with 1969/70. The structure of imports has been changing, with a greater proportion being for development purposes and a lower proportion for consumption. Imports of consumption goods were 45.2 per cent of total imports in 1968, 31.2 per cent in 1969 and 29.4 per cent in 1970. On the other hand, imports of capital goods were 35 per cent of the total in 1970/71 by comparison with 13 per cent in 1968.

The net deficit in the current account of the balance of payments increased from US\$449 million in 1969 to US\$476 million in 1970. The amount of foreign aid, in the form of both programme aid and project aid, increased from US\$359 million in 1969 to US\$393 million in 1970, while the inflow of private capital has increased from US\$17 million in 1969 to US\$137 million in 1970/71. A summary of the balance of payments is given in table II-3-9.

Table II-3-9. INDONESIA: BALANCE OF PAYMENTS
1969-1970/71 (SUMMARY)
(in million US dollars)

	1969	1969/70	1970/71 ^a
Goods and services			
Exports f.o.b.	995	1,039	1,204
Imports f.o.b.	-993	-1,071	-1,201
Services (net)	-396	-417	-479
Balance on current account .	-394	-449	-476
Official transfers ¹ and capital (programme and project aid)	315	359	393
Miscellaneous private capital (net)	63	17	137
Debt service payments	-39	-44	-68
Monetary movements (net) . .	20	43	21
Allocation of SDR	—	35	28
Net errors and omissions . . .	35	39	7
Balance on capital account .	+394	+449	+476

Sources: Appendix to the state address of the President to the Members of Parliament, 16 August 1971; Indonesian Financial Statistics, Bank of Indonesia, October 1971.

^a Preliminary figures.

¹ From 1969 onwards, the fiscal year has been changed from the calendar year to an April-March year.

A major event was the devaluation of the rupiah by 9.5 per cent on 23 August 1971, the intention being to encourage exports in the face of the United States measures of 15 August, which were considered likely to affect indirectly the demand for Indonesian products in Western Europe and Japan. As already noted, exports had already slumped noticeably in the period since April 1971. It is too early to say, however, whether the move, which was accompanied by changes in various export taxes and in differential exchange rebates for imports from various aid sources, will be successful in encouraging an increase in the volume of exports or what the ultimate effect on total receipts is likely to be. The effect on imports must also be taken into account. These continued to rise rapidly throughout 1970 and the early part of 1971, and a number of measures had already been taken, such as tighter control over the issue of merchant letters of credit, to restrain import demand. The devaluation should, on balance, be helpful, but, with the pent-up demand for imports, it is not certain that the measure will be more than a marginal check to import demand.

(c) *Public finance*

Government routine revenue increased from 243.6 thousand million rupiahs in 1969/70 to 344.7 thousand million rupiahs in 1970/71, while routine expenditure increased by 33.1 per cent from 216.5 to 287.7 thousand million rupiahs for the same period. This has resulted in a substantial increase in the current surplus by comparison with that of the previous financial year.

The increase in revenue was due largely to changes in tax structure (especially changes in the minimum limit of taxable income and the reduction in tax rates), an increase in the efficiency of tax administration and improvement in tax collection.

Revenue from all foreign loans and aid has also increased by about 23.8 per cent, from 94,500 million rupiahs in 1969 to 117,000 million rupiahs in 1970/71. The government budget surplus and revenue from foreign loans are the major sources of development finance.

Total development expenditure was 167.9 thousand million rupiahs in 1970/71, 38 per cent higher than in the previous year. Thus, during the period reviewed there has been a considerable increase, not only in current expenditure, but also in public investment activity. At the same time, the Government has been able to finance this expanded activity through the mobilization of domestic resources and foreign aid, while maintaining internal price stability.

Revised estimates for the 1971/72 financial year provide for a further increase of about 19 per cent in both routine revenue and expenditure. Development expenditure originally budgeted to increase by about 44 per cent over 1970/71 is now expected to increase by only 35 per cent, largely because of expected lower foreign aid receipts. The estimated over-all surplus is 5,900 million rupiahs, about the same as in 1970/71.

(d) *Investment*

A notable feature of recent years has been the sharp rise in the level of investment. Estimates by the Central Bureau of Statistics show that, while in 1967 investment was only 8 per cent of GDP, in 1970/71 it was 13 per cent. A major factor in this change has been the atmosphere of confidence induced by economic stability and the improvement of economic conditions generally. But government measures to expand private investment through improved credit facilities, tax exemptions and other incentives have also been an important influence. The flow of foreign private investment has continued to gather momentum. From 1967 up to September 1971, 428 projects valued at US\$1,600 million have been approved. In the year ended March 1971, approved projects totalled US\$305 million, an increase of 27 per cent over the previous year. Approvals in the six months ended September 1971 were valued at US\$195 million. The most important sectors have been oil, mining and forestry, but, in recent times, the manufacturing sector, especially textiles, chemicals, non-metallic minerals and metal products, has proved increasingly attractive. The principal sources of foreign capital have been the United States, Japan, Hong Kong, Australia, the United Kingdom and the Federal Republic of Germany. In a large percentage of cases (69 per cent of the total), projects involve joint ventures by foreign and Indonesian firms.

(e) *Money, credit and prices*

During the fiscal year 1970/71 the volume of credit outstanding has increased by 1,192 thousand million rupiahs or 45.4 per cent. In March 1971, total credit outstanding reached 381.3 thousand million rupiahs, of which 208.8 thousand million rupiahs originated from the Central Bank, 141.5 thousand million rupiahs from various state banks, and 37 thousand million rupiahs from private banks.

Private saving in the form of time deposits, encouraged by continuing economic stability and high interest rates, reached 93 thousand million rupiahs at the end of October 1971, nearly double the level of a year earlier. The money supply rose by 34.3 per

cent in calendar year 1970 and by a further 27.8 per cent by the end of October 1971. The ratio of currency to demand deposits in money supply remained at 62:38 throughout 1971. Further progress towards price stability has been achieved. During 1970, the index of consumer prices for Djakarta rose by 8.9 per cent. There was a further rise of 5.8 per cent in the first quarter of 1971, since when prices (food and housing) have fallen, so that, by the end of October 1971, the index stood at the same level as in December 1970.

Economic problems and prospects

During the period 1967-1969, the aim of economic policy in Indonesia was to achieve economic stability and thereafter to consolidate and prepare the economy for economic growth and development. The success of these efforts is now manifest. The orientation of budget, money and credit policies has shifted in 1970 and 1971 to more positive measures to stimulate investment and productive activities, and to improve the administrative and institutional framework within which these are to operate. Policies aimed at expanding exports, especially of non-traditional items, increasing agricultural productivity, and promoting rapid growth in the manufacturing sector are all part of this long-term approach to the development problem in Indonesia. According to official pronouncements, economic development will, in the future, mean, in general, a gradual shift of the economic structure towards an industrial economy.

In order to maintain the present growth of GDP of 6-7 per cent per year, the rate of growth of saving and investment must be raised further, and exports increased more rapidly. Although foreign aid and official transfers of capital will still play an important role, they cannot be relied upon indefinitely.

For the rest of 1971, domestic revenue of the government budget from taxes and capital inflows through official transfers should be in accordance with plans. Exports are likely to pick up only when economic conditions in the industrial countries improve, which may not be until mid-1972. On the other hand, exports of oil continue to expand and this has helped to compensate for the sluggishness of traditional exports in 1971. Exports of timber and other non-traditional products have also been increasing, and the likelihood of further important developments in the mining sector makes the outlook for exports reasonably optimistic for the next few years.

During the period reviewed, the Indonesian economy has entered a period of economic expansion and a firmer base for future development has been established. Nevertheless, Indonesia still faces

a number of basic institutional problems, in both the private and the public sector, which require solution.

Iran

Introduction

The Iranian economy has been growing fast for over a decade. During the third plan period (1962-1967) GNP rose by an average of 8.5 per cent per annum, and, during the first three years of the fourth plan (1968-1972), the average annual growth rate accelerated to roughly 10 per cent. Investment expenditure has been growing by about 10 per cent yearly economic growth has been accompanied by a remarkable degree of price stability, and the GNP price deflator rose by an average of only 1.7 per cent over the eight-year period.

During 1970/71, real GNP increased by 10.3 per cent and there was an improvement of 7.2 per cent in *per capita* income. Prices remained stable and investment and savings rose further. The only weakness was the balance of payments which has continued to be a source of concern for some time, mainly on account of the rising level of development and other imports. However, this constraint is expected to be overcome in 1971/72 because Iran's income from oil will increase sharply as a result of the increase in the posted price of oil and in the tax rate (from 50 per cent to 55 per cent) under the new oil agreement. The prospects for 1971/72 are for a large rise in GNP and investment activity, an increase in employment, a balance of payments surplus and a decline in the debt-service ratio. However, agricultural production is likely to fall sharply due to the current deterioration in weather conditions.

Major developments in 1970/71

(a) GNP

Iran's real GNP increased by 10.3 per cent during 1970/71, exceeding considerably the fourth plan annual growth rate target of 9.4 per cent. As population increased by 3.1 per cent, *per capita* real GNP rose by 7.2 per cent. The oil and services sectors contributed the largest shares in the growth rate, accounting for roughly one-third each of the total. As Iran's income from oil rose by 17 per cent during the year, partly as a result of more favourable terms obtained under the new oil agreement reached in February 1971 and partly owing to increased output, the oil sector emerged as the leading sector, accounting for about 27 per cent of the GDP. The increase in agricultural production, on the other hand, was modest, owing to continuation of drought conditions.

Table II-3-10. IRAN: GROWTH OF EXPENDITURE AND GROSS NATIONAL PRODUCT

(at constant 1959/60 prices)

	1969/70 (thousand million rials)	1970/71	Rate of growth (1969/70)	Rate of growth (1970/71)	Fourth plan projections
			(per cent)	(per cent)	(per cent)
Consumption expenditure	463.4	512.1	11.8	10.5	7.4
Private sector	361.0	392.2	10.2	8.6	6.7
Government sector	102.4	119.9	17.7	17.1	9.8
Gross domestic fixed-capital formation .	132.1	144.2	1.9	9.2	13.6
Current account balance of payments ^a .	-10.1	-10.8	-25.2	6.9	—
Gross national product	585.4	645.5	10.3	10.3	9.4

Source: Central Bank of Iran, *Annual Report*, 1971, p. 117.^a The figures shown here are at constant prices and differ from those shown in the balance of payments statement.

Value added in the agricultural sector increased by only 3.0 per cent as against the fourth plan average annual target of 4.4 per cent. Industrial production, however, expanded vigorously and the growth rate of the industries and mining sector improved from 10.2 per cent in 1969/70 to 13.2 per cent in 1970/71, exceeding slightly the plan target of 13.0 per cent.

The growth momentum originated mainly from the domestic sector. Although both consumption and investment expenditures expanded strongly, the rate of increase in the latter was substantially higher than in 1969/70 while that of the former recorded some decline. However, the rate of increase in consumption expenditure, particularly in the government sector, exceeded the fourth plan projections and that of private and public sector fixed investment fell short of the plan target.

The sectoral distribution of fixed investment proceeded on a pattern similar to that in 1969/70; the largest share went to the industries and mining sector (33.5 per cent) followed by housing (22.8 per cent) transport and communication (21.0 per cent), services (16.7 per cent) and agriculture (5.7 per cent). The ratios of investment and savings to GNP declined slightly, from 22.5 and 20.8 per cent respectively in 1969/70 to 22.3 and 20.7 per cent in 1970/71.

(b) Money supply

Money supply expanded by 7.7 per cent during 1970/71. The expansion in money supply was caused by both the public and private sectors, but the former exercised a more pronounced impact; net bank credit to the public sector rose by 42 per cent, as

against the rise of 16 per cent in bank credit to the private sector. The foreign sector, on the other hand, exercised a sharply contractionary influence on the money supply.

(c) Public finance

Both government revenue and expenditure increased strongly during 1970/71, the former rising by about 20 per cent and the latter by 18 per cent. Revenue from direct taxes and oil increased substantially, by 26 and 20 per cent respectively, while revenue from indirect taxes increased at the comparatively lower rate of 16 per cent. Although the revenue surplus increased substantially during the year, the over-all budget deficit widened as development expenditure increased. Development expenditure was allocated: production sectors received 61 per cent, infrastructure 31 per cent and social services 8 per cent.

Table II-3-11. IRAN: GOVERNMENT REVENUE AND EXPENDITURE

(in thousand million rials)

	1969/70	1970/71	Rate of growth (percentage)
Revenue	143.0	171.4	19.9
Current expenditure	114.4	134.4	17.5
Revenue surplus	28.6	37.0	29.4
Development expenditure	83.0	97.9	18.0
Over-all deficit	54.4	60.9	11.9

Source: Central Bank of Iran, *Annual Report*, 1971, p. 13.

(d) Prices

The pressure on demand was offset by the increased domestic production of manufactured consumer goods and the import of food items. The share of consumption goods in imports rose from 11 per cent in 1969/70 to 14 per cent in 1970/71. Prices, therefore, remained remarkably stable during 1970/71, the consumer price index rising only 1.3 per cent compared with the increase of 3.6 per cent in 1969/70. The increase in the wholesale price index (2.5 per cent) in 1970/71 was also smaller than in the previous year (3.4 per cent).

(e) Balance of payments

The pressure on the balance of payments increased during 1970/71. The over-all deficit in the balance of payments increased from US\$70.9 million in 1969/70 to US\$239.8 million in 1970/71. Export receipts rose at a high rate of 11.3 per cent and imports by 15 per cent for goods and 11 per cent for services. The current account deficit, therefore, increased by US\$121.5 million, or 22 per cent. On capital account, the surplus increased by only US\$14.6 million or 3.7 per cent.

Table II-3-12. IRAN: BALANCE OF PAYMENTS
(in million US dollars)

Item	1969/70	1970/71	Change in percentage
Current receipts	1,518.7	1,690.1	11.3
Current payments	2,072.2	2,365.1	14.1
Net current account (1-2) .	-553.5	-675.0	22.0
Net capital account	398.8	413.4	3.7
Miscellaneous	83.8	21.8	-74.0
Over-all balance of payments	-70.9	-239.8	238.2
Foreign exchange reserves .	241.4 (Dec. 1969)	135.6 (Dec. 1970)	-43.9

Source: Central Bank of Iran, *Annual Report*, 1971, pp. 132-134.

(f) Employment situation

Except for underemployment or disguised unemployment, the employment situation seems to have improved in 1970/71 after some deterioration took place in 1969/70. The ratio of the unemployed to the economically active population, which had increased from 11.8 per cent in 1968/69 to 12.3 per cent in 1969/70, declined to 10.7 per cent in 1970/71. Moreover, the number of unemployed, which had risen by 6.7 per cent to 996,000 in 1969/70, declined

by 10.6 per cent to 890,000. The improvement is seen to be substantial when account is taken of the facts that the economically active population increased by 2.8 per cent in 1970/71 and that the flow of rural unemployed and underemployed to urban areas added to the pressure. Migration of rural workers to urban areas seems to have increased considerably, particularly because of the labour surplus created in the rural areas by the introduction of mechanized farming. Evidence of this is also provided by the proportionate and absolute decline of the labour force engaged in agriculture.

Table II-3-13. IRAN: LABOUR FORCE, BY SECTOR

Sector	1968/69	1969/70	1970/71
Agriculture	3,113,000	3,085,000	3,057,000
Industry and mining .	1,991,000	2,036,000	2,222,000
Oil	42,000	42,000	43,000
Services	1,819,000	1,886,000	2,058,000

Source: Central Bank of Iran, Research Department.

Outlook for 1971/72

The prospects for the Iranian economy in 1971/72 appear to be for an even better performance than in 1970/71. The balance of payments constraint is expected to be overcome as a result of the new oil agreement. Iran's income from oil is expected to increase by 67 per cent in 1971/72. Current receipts, therefore, are expected to increase by 55.4 per cent, compared with an increase of 27.8 per cent in current payments. Given an anticipated 14.4 per cent increase in net capital account receipts, the balance of payments is likely to show an over-all surplus of US\$120 million in 1971/72, compared with a deficit of US\$239.8 million in 1970/71. Reserves are expected to increase by US\$200 million and the debt-service ratio to decline from 20 per cent to 16 per cent.

Investment expenditure is expected to increase by 21 per cent, and private and government consumption expenditure by 8 per cent and 20 per cent respectively. It is anticipated that real GNP will increase by a record 14 per cent despite a 5 per cent fall in value added in agriculture on account of adverse weather conditions. Prices advanced by 5 per cent in the earlier half of the year, but a further increase in price pressure is not anticipated. The employment situation should improve further as aggregate demand expands, and shortages of skilled manpower could emerge.

Japan

Introduction

In mid-1970, Japan's five-year-old business boom slowed to a halt. Since July 1970 industrial output has stagnated and the growth rate in real GNP has declined. The slow-down in business activity was characterized by a gradual adjustment of fixed business investment which had been expanding previously by about 25 per cent per annum. Since capacity output continued to expand at an annual rate of about 11 to 12 per cent, there has been a widening gap between actual and potential output which reached the level attained in the 1965 recession. The reflationary measures taken by the Government do not seem to have been strong enough to reverse this trend.

The business slow-down has also resulted in a substantial increase in the already large trade surplus. The reasonably adjusted surplus in the current account rose from \$2.1 billion in 1970 to \$4.6 billion in the first half of 1971, and the June level of foreign exchange reserves, at \$7.6 billion, was double that of a year before.

Wages continued to rise despite sluggish business conditions, but their rate of increase is levelling off as a result of the recession in activity. Wholesale prices have been falling gradually since the second quarter of 1970. This gradual decline has tended to enhance further Japan's international competitiveness.

Table II-3-14 JAPAN: MAIN ECONOMIC INDICATORS
(per cent per annum)

	1969	1970	1971 ^a	1972 ^a
GNP	12.6	9.7	4.1	8.6
Industrial output	17.7	13.7	2.8	9.2
Exports of goods and services	23.5	16.3	9.4	5.1
Imports of goods and services	22.0	18.0	-0.9	17.6
Consumer price index	—	7.3	4.8	...
Private investment	—	12.1	-1.5	7.2

Source: Derived from tables in the text.

Note: All years are fiscal years commencing 1 April.

^a Estimates of Japan Economic Research Center.

Recent economic developments

(a) Reasons for the recession — the adoption of restrictive policies in 1969

The present recession was partly an adjustment to a preceding period of extraordinary expansion and

partly a result of restrictive policies adopted in 1969. The application of those policies, however, has been gradually relaxed since July 1970 to counteract the reduced rate of growth in the economy. Restrictive policies were adopted to counteract increases in both wholesale and consumer prices which were partly "imported" because of the rise in import prices and partly a result of excess demand. Measures adopted included a tight money policy for the period September 1969 to January 1971 which involved not only a rise in the official discount rate but also increases in long-term interest rates. The growing trade surplus tended to offset the effect of these measures on the domestic money supply. Average interest rates on bank loans, however, continued to rise, mainly because of strong investment demand in the first half of 1970. The rate of corporate tax (including local tax) was increased by about 2 per cent to 42 per cent.

The growth of government fixed investment was also reduced. The rate of increase for fiscal 1969 was only 5.9 per cent in real terms, the lowest since 1964. The rate was raised to 13.3 per cent for fiscal 1970. Steps taken to reduce the overproduction of rice and the build up in government rice stocks provided an additional deflationary factor.

(b) Economic conditions before Nixon's new economic policy

As table II-3-15 indicates, although exports measured in current prices continued to expand at a rapid pace, private investment in inventories and fixed assets started to level off after the adoption of the restrictive policies. Private consumption spending slowed in the third quarter of 1970, and wholesale prices have stabilized since March. The sharp decline in the rate of increase in industrial production since July reflected the pessimism of business sentiment arising from the excessive accumulation of inventories. Real GNP and imports also stopped rising in the fourth quarter of 1970.

With the gap between actual and potential real GNP widening, and a growing trade surplus, the direction of monetary policy was reversed in the autumn of 1970. The official discount rate was lowered by 0.25 per cent respectively in October 1970 and January 1971, leaving it at its pre-squeeze level. Fiscal policy was also given a slightly inflationary stance.

Prior to the policy measures announced by President Nixon, the business recession was continuing and few signs of recovery were discernible despite a further lowering of the official discount rate by 0.25 per cent and an increase in public investment, through government financing. Idle capacity rose to as high

Table II-3-15. JAPAN: POTENTIAL AND ACTUAL REAL GNP AND TRADE SURPLUS
(AT SEASONALLY ADJUSTED ANNUAL RATE IN 1965 PRICE^a)

(in thousand billion yen)

	1969				1970				1971				1972		1969	1970
	4	1	2	3	4	1	2	3	4	1	2	3	4	1	(fixed)	(fixed)
Potential real GNP ^b	54.21 (3.2)	55.88 (3.1)	57.55 (3.0)	59.22 (2.9)	60.90 (2.8)	62.49 (2.6)	64.18 (2.7)	65.77 (2.5)	67.36 (2.4)	68.99 (2.4)	70.58 (2.3)	72.17 (2.2)	73.76 (2.1)	75.35 (2.0)	53.16 (12.4)	60.03 (12.9)
Real GNP	52.99 (4.8)	54.54 (2.9)	56.14 (2.9)	57.33 (2.1)	58.49 (-1.0)	59.64 (-0.2)	60.79 (0.3)	61.94 (0.3)	63.09 (0.3)	64.24 (0.3)	65.39 (0.3)	66.54 (0.3)	67.69 (0.3)	68.84 (0.3)	52.14 (12.6)	57.19 (9.7)
GNP gap (= 1. - 2.)	1.22	1.34	1.41	1.89	2.41	2.85	3.39	3.83	4.27	4.75	5.19	5.63	6.07	6.51	1.02	2.84
GNP (%)	2.3	2.5	2.5	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3	1.9	4.7
Industrial production	199.2	205.5	216.0	221.5	227.0	232.5	238.0	243.5	249.0	254.5	260.0	265.5	271.0	276.5	194.1	220.4
Index (1965 = 100)	4.8	3.2	5.1	2.5	-0.6	2.0	-1.2	3.4	4.8	6.2	7.6	9.0	10.4	11.8	17.7	13.5
Exports of goods and services	7.33 (3.8)	7.76 (5.9)	8.05 (3.7)	8.45 (5.1)	8.81 (4.2)	9.17 (6.7)	9.54 (5.8)	9.91 (4.2)	10.28 (3.6)	10.65 (3.0)	11.02 (2.4)	11.39 (1.8)	11.76 (1.2)	12.13 (0.6)	7.18 (23.5)	8.67 (20.7)
Imports of goods and services	6.54 (4.1)	7.00 (7.1)	7.38 (5.4)	7.75 (5.1)	8.11 (4.5)	8.49 (3.9)	8.87 (3.3)	9.25 (2.7)	9.63 (2.1)	10.01 (1.5)	10.39 (0.9)	10.77 (0.3)	11.15 (-0.3)	11.53 (-0.9)	6.37 (22.0)	7.72 (21.2)
Net exports of goods and services	0.79	0.76	0.67	0.70	0.70	0.68	0.67	0.66	0.65	0.64	0.63	0.62	0.61	0.60	0.81	0.95
Net exports of goods and services (billion \$)	2.20	2.10	1.85	1.96	2.07	2.18	2.29	2.40	2.51	2.62	2.73	2.84	2.95	3.06	2.25	2.63

Source: Economic Planning Agency.

^a Figures in parenthesis are growth rates.

^b Economic Planning Agency, Quarterly Econometric Model.

a level as that which prevailed during the 1965 recession. The over-all balance of payments continued to rise, with a significant rise in capital inflow in May, and, by early August, official reserves reached \$8.0 billion, more than twice as high as the same month in the previous year.

In view of the large trade surplus which persisted, the Government decided on an "eight point programme" of action which included such measures as the extension of special preferential tariff rates to imports from developing countries, reduction of tariff rates generally and of non-tariff barriers to trade, liberalization of capital flows and the abolition of preferential treatment for exporters. Most of these measures were not specified in quantitative terms, although the programme was intended to be more than a confirmation of principles to which the Government had committed itself. However, with the recession becoming more serious, resistance of the business and farming sectors to further liberalization intensified.

Developments in economic policy

There are several factors which must be taken into account when evaluating the impact of the United States policy measures and the subsequent exchange rate re-alignments. Although the United States' import surcharge has been terminated and the re-alignment of major currencies determined, the final outcome also depends on the value of structural parameters, such as price elasticities of demand for exports and imports, GNP multipliers and domestic price responsiveness. The impact will also vary according to the monetary and fiscal policy-mix adopted.

Most econometric studies suggest that the demand for Japanese exports is elastic and, although the Japanese demand for imports is probably inelastic, the net direct price effects of a revaluation should reduce the trade surplus. To some extent this effect would be offset because the decline in import prices accompanying the revaluation would eventually lower export prices. At the same time, a fall in export income would induce a downward multiplier effect in the Japanese economy, where the level of private investment activity depends heavily on developments in the external market. If not compensated for by expansionary monetary or fiscal policies, the resulting change in GNP by the end of the second year of the multiplier process could be as large as three to four times the original change in output. Thus the fall in net exports would also cause a decline in total production and an associated fall in imports which would offset the original effect of the revaluation. This deflationary effect could be slightly modified,

since the fall in import and related prices usually tends to raise profits and investment in such industries as oil refining, steel and electric power. A decline in import prices also may result in a fall in the prices of investment and consumer goods, which in turn tends to stimulate aggregate demand. These facts seem likely to offset, to some extent, the deflationary ones stated earlier.

The longer-term effects of upward revaluation could be desirable for Japan, both internally and externally, provided that appropriate demand management policy is maintained. The general effect would be to accelerate desirable changes in the long-run structure of production. Internally, it allows a shift of resource allocation from exports to more welfare-oriented expenditure in areas such as housing, urban development, anti-pollution and social security. Externally, imports, especially from developing nations, can be increased. This will eventually cause a fundamental change in the production structure, with less competitive and often labour-intensive sectors losing their markets within Japan and in third markets to competitors generally and to competitors from the developing countries in particular. This would lead to a more efficient international allocation of resources.

Taking account of all the factors just discussed, but especially the short-term impact, the Economic Planning Agency (EPA) recently revised downwards its forecast of real GNP growth for fiscal 1971 from 10.0 per cent to 5.5 per cent in terms of real growth. As of early November, the growth of exports, especially to the United States, has been slowing down and a sharper decline is expected in 1972. Industrial production, which increased slightly in the third quarter of 1971, is likely to level off again as a result of the fall in export demand.

Prospects for 1972

Looking ahead to the next fiscal year, it is likely that the present stagnant business conditions will continue up to the latter half of fiscal 1972, when a gradual upturn is expected. This would result partly from what are expected to be strong anti-recession policy measures and partly from self-generating forces. The speed of the recovery will depend considerably on the timing and strength of the counter-cyclical policy measures adopted by the Government.

The Japanese Economic Research Centre (JERC) forecasts that real GNP will grow by 8.6 per cent in the 1972 fiscal year, assuming prompt and strong government policy. Their estimates, set out in table II-3-16, are based, among other things, on the assumption of a yen revaluation of 14.3 per cent in relation

to the US dollar (which is approximately equal to the exchange rate alteration realigned), a removal of the United States 10 per cent surtax and a 25 per cent rise in public investment at current prices. The pessimistic forecast for the rate of increase in GNP in the 1971 fiscal year results from the increase in idle capacity in industry and the psychological shock given by the decline in the rate of growth of exports and the international monetary crisis in general. There seems to be general agreement that the current account surplus will not fall substantially. The JERC forecast suggests that it will only decline from \$5.6 billion to \$4.3 billion in fiscal 1972. However, it can be argued that the estimate for the expected growth of exports (5.1 per cent for fiscal 1972) is too low and that the projected fall in the current account surplus is too optimistic.

Table II-3-16. JAPAN: JERC FORECAST FOR
FISCAL YEAR 1972
(in thousand billion yen of 1965 prices)

	FY 1970	FY 1971	FY 1972
GNP	57.19 (9.7)	59.56 (4.1)	64.70 (8.6)
Private consumption	28.02 (8.1)	30.01 (7.1)	32.19 (7.3)
Private residential construction .	3.55 (11.4)	3.84 (8.2)	4.50 (17.2)
Private business investment . .	13.28 (12.1)	13.08 (-1.5)	14.03 (7.2)
Change in private inventories .	2.77 (30.1)	1.04 (-62.6)	1.42 (36.3)
Government consumption . . .	3.94 (4.8)	4.10 (4.3)	4.25 (3.6)
Government fixed investment .	4.89 (13.3)	5.99 (22.5)	7.54 (26.0)
Change in government inventories	-0.02 (-112.7)	-0.06 (-208.9)	-0.01 (87.7)
Exports of goods and services .	7.78 (16.3)	8.52 (9.4)	8.95 (5.1)
Less: Imports of goods and services	7.01 (18.0)	6.95 (-0.9)	8.17 (17.6)
Industrial production index . .	220.4 (13.7)	226.5 (2.8)	247.4 (9.2)
Current balance ^a	2.37	5.59	4.27

Source: JERC, *Quarterly Forecast*, No. 19, December 1971.

Note: Figures in parentheses are percentage changes in the year concerned.

^a Billion US dollars.

The present large trade surplus in the balance of payments will not be easily reduced in the absence of an active business recovery equivalent to at least a sustained growth rate of potential real GNP of 10.0 per cent. If this were to occur there may be some modest rise in prices, but this is not likely to be serious owing to the existence of large amounts of idle capacity. Together with the exchange rate appreciation the further promotion of trade liberaliza-

tion will bring about a rise in imports, but the main factor that will reduce the trade surplus is a vigorous business recovery.

In conclusions, two sets of policy options appear to confront the Japanese economy. The more conservative of these options would encourage a slower rate of internal economic development with price stability and a sustained although modified current account surplus position. The alternative policy set would seek a higher rate of growth in the domestic economy by rapidly expanding socially-oriented public expenditure and a more rapid return to external balance by policies which would expedite the structural change required.

Khmer Republic

Introduction

The war which broke out in April 1970 and which has affected all sectors of the economy is the dominating factor in the Khmer Republic's current economic situation and its short-term outlook. Production of all major agricultural commodities has fallen and rubber exports, which accounted for 41 per cent of total exports in 1969, have ceased. As a result, the trade deficit position worsened in 1970 and 1971 and foreign assets fell rapidly. The government budget deficit has increased rapidly, as a result of reduced receipts from taxation and the large increase in military expenditure. The financing of the deficit by borrowing from the Central Bank has led to a more than twofold rise in the money supply since the start of 1970. The increased money supply and supply shortages involving basic goods have resulted in serious inflation. To combat the deteriorating balance of payments position, the Government adopted a number of policy measures in November 1971, including a 150 per cent devaluation of the exchange rate.

Table II-3-17. KHMER REPUBLIC:
MAJOR ECONOMIC INDICATORS
(in million riels)

Item	1969	1970	1971
GDP per capita ^a	5,500	...	...
Currency in circulation	6,150	11,580	14,562 ^b
Consumer prices ^c	354	397	759 ^b
Exports	2,729	2,208	339 ^d
Imports	4,234	2,686	1,014 ^d
Gold and foreign exchange reserves	...	3,345	1,965 ^e

^a Riels: unofficial estimate.

^b May 1971.

^c Phnom Penh, Working Class General Price Index, 1949=100.

^d First four months. The estimates given of exports and imports are those of the Office National des Changes.

^e August 1971.

Recent economic developments

In 1966, the country's GDP was estimated unofficially to be 32,000 million riels, excluding any allowance for subsistence consumption. Unofficial estimates indicate that, in real terms, GDP rose by about 3 per cent per annum, to reach 35,100 million riels in 1969. At the official population estimate of 7 million, this represents a *per capita* income of about 5,000 riels. However, taking account of the current situation in the country and of the recent trends in production, it seems certain that real GDP fell in both 1970 and 1971.

(a) Agriculture

Paddy production, the principal export crop, reached a record level of 3.8 million tons for the season ending March 1970, but dropped to 2.7 million tons in the 1970/71 season and the Ministry of Agriculture anticipates a further drop to 2.4 million tons for 1971/72. Disturbed and uncertain conditions in the countryside, a shortage of available labour and working animals, as well as a reduction in the cultivated area, have been the major factors accounting for the decline in production. Price uncertainty also has greatly affected rice production.

An absolute decline in production has characterized almost all products; it has been particularly harsh for rubber. Rubber output has fallen from 51,800 tons in 1969 to a nil estimate for 1971 because the northeast region, where the rubber plantations are situated, is no longer under the control of the Government. Forestry, animal-rearing and fishing have all suffered serious setbacks.

(b) Industry and transport

Estimates suggest that industrial production was reduced by half in 1970 and that the decline is continuing in 1971. Of the state enterprises, only the cement, sugar-refining, textile and plywood factories are still functioning, but transport difficulties have forced them to reduce their activities. Oil-refining and paper and phosphate production have all ceased in the public sector. In the face of manpower and raw material shortages, private industry is either operating far below capacity or not at all.

The insecurity which exists along national highways has severely disrupted transport. In addition, since the war began the Government has requisitioned large numbers of lorries, buses and general vehicles so that both internal trading and the movement of merchandise to the ports have been severely disrupted.

(c) Foreign trade¹

A large degree of price uncertainty, together with the deteriorating conditions mentioned above, has resulted in a drastic drop in export production. Original official forecasts of export earnings for 1970 foresaw total receipts of 5,255 million riels, but this has been revised downwards to 2,271 million riels and the forecast for 1971 is a mere 795 million riels. Even this latter figure may not be reached. On the import side, original figures for 1970 gave an estimate of 3,700 million riels, which was subsequently revised to 2,700 million riels. An estimate of 5,000 million riels for imports has been made for 1971. Taken together, these figures mean that the estimates of the trade deficit have been changed from an original surplus of 1,500 million riels to a deficit of 400 million riels in 1970 and of 4,200 million riels in 1971.

In this context it is important to note that the United States Government, under its Commodity Importation Programme, has accorded the Khmer Republic sufficient economic assistance to cover its import needs.

(d) Public finance

The war has resulted in a dramatic increase in the Government's budget deficit. The gap between ordinary budget receipts and expenditures has been widened from both sides. Receipts have suffered a drop of more than one-third as a consequence of the fall in production. Expenditure, on the other hand, has doubled as a result of the Government's military expenditure.

The budgetary position for both 1970 and 1971 has deteriorated seriously. The original estimate of the deficit for 1970 of 475 million riels was subsequently revised to a figure of 7,241 million riels. For 1971, the original appropriations adopted by Parliament in July had to be revised because foreign assistance was less than anticipated. The original estimate for the 1971 deficit of 6,038 million riels was revised to 10,107 million riels. Further revisions are possible.

(e) Money supply and prices

The 1971 deficit is being financed by borrowing from the Central Bank and this is increasing the money supply. This supply, estimated at 6,150 million riels at the end of 1969, rose to 14,562 million riels in July 1971, implying an increase of about 140

¹ The figures quoted in this section are not consistent with those given in table II-3-17, which are from a different source.

per cent in 18 months. During this period, advances from the National Bank of Cambodia grew from 1,188 million riels to 12,600 million riels.

The increase in the money supply, at a time when the supply of basic foodstuffs and agricultural raw materials was seriously reduced, led to a rapid acceleration of the inflation. The index of food prices for the working class in Phnom Penh (1949=100), which grew from 347 in 1969 to 417 in 1970, had risen to 900 by August 1971.

Recent policy measures and the short-term outlook

To stabilize the economy and provide some incentives to producers, the Government recently adopted a special programme. One of the measures has been a new exchange rate of 139.72 riels per US\$1 set by the Cambodian National Bank.

Another measure is the establishment, under the auspices of IMF, of a Foreign Exchange Stabilization Fund, financed by external assistance from various developed countries. It is estimated that contributions amounting to US\$25 million will be necessary during the first stage of the Fund's operation.

It is too early to forecast whether the programme will succeed in combating inflation, and it is difficult to predict other economic developments if the war continues.

Laos

Introduction

Laos faced a difficult economic situation during 1971. The floods in the Vientiane plain affected adversely the annual rice crop. The price situation deteriorated. Government revenue declined, while civil expenditure continued to rise. The balance of trade deficit, which was already huge in 1970, seems to have increased further, as the drawings in the Foreign Exchange Operations Fund in 1971 became so heavy that the free market value of the kip had to be adjusted downward by 20 per cent. This measure was supplemented by the imposition of a wide range of customs duties on items considered non-essential as also the abolition of the forfeit system. The Government took measures to promote agricultural production and fisheries. The Nam Ngum Dam project was reported to be progressing as planned and work was begun on numerous small development projects and industries. The measures taken during 1971 may help improve the economic performance in 1972.

Recent economic developments

The rate of increase in rice production which had accelerated substantially since 1967, seems to have suffered a setback as a result of the disastrous floods in the Vientiane plain in August/September 1971. Production estimates are not available, but it seems that *per capita* output remained more or less stagnant. The performance of the other important sector, namely forestry, was no better. The natural reserves of timber in Laos are immense, and timber is a leading export item. However, the lack of access roads and the absence of a seaport, coupled with the lack of security in large areas, have rendered optimal exploitation almost impossible. Production of timber and charcoal actually declined in the latter half of 1970 and this trend continued in 1971.

As for industry, it is still in the nascent stage and the industrial sector consists of small units producing such goods as cigarettes, shoes, matches, sauces, soft drinks and furniture. Again no estimate of output is available, but, given the very small size of this sector is in the economy of Laos, whatever change in its output took place was of marginal significance.

The budgetary position of the Government has been under considerable strain. In 1970/71, the budget deficit amounted to 12.3 billion kip, as against the forecast of 8.8 billion kip for that year and the actual deficit of 10.0 billion kip in 1969/70. The increase in the deficit was due mainly to the shortfall of 0.5 billion kip in import duty on gold and of 1.2 billion kip in other import duties.

Money supply, which had increased by 12 per cent in 1969, rose further by 11 per cent in 1970 and by 9 per cent by the end of September 1971.

The country's balance of trade has been recording huge deficits which have been met by contributions from the United States, the United Kingdom, France, Japan and Australia. The main export items are tin, timber and coffee. Exports cover only 5 per cent of imports. In 1970, the value of total imports amounted to US\$54 million as against exports of only US\$2.9 million.

The first phase of the Nam Ngum Dam project was inaugurated in December 1971. The generating capacity which is 30,000 kW in the first phase will increase to 135,000 kW on completion of the final phase. Apart from generation of power, it is envisaged that a large part of the plain of Vientiane will benefit from the large irrigation projects to be undertaken.

The Mekong Committee, in co-operation with ECAFE, has undertaken a number of studies for irrigation schemes and hydro-electric plants. The Vientiane plain, with its vast agricultural potential, has received the greatest attention, and the development plan for its Casier Sud, now under negotiation, covers an area of 6,000 hectares.

Policy measures

Agriculture is the most important sector of the Laotian economy and provides employment and sustenance to 80-90 per cent of the population. The subsistence sector is, however, very large and production falls short of the requirements of the entire population of the country, necessitating import of foodstuffs, notably from Thailand. The Government has in recent years made efforts to increase domestic output with the ultimate aim of achieving self-sufficiency in basic foodstuffs. IRRI rice, which allows double cropping, was introduced in 1967 and the use of fertilizers and insecticides has become more widespread. The Agricultural Development Organization (ADO), a joint Laos-United States venture, has been extending loans to farmers for irrigation projects, seeds, fertilizers, insecticides agricultural machinery. Small irrigation pumps have been sold to vegetable growers with a view to increasing the area under cultivation. The Nam Ngum Project alone is expected to irrigate some 34,000 hectares when it is fully operational and there are plans for some 200 small dams for regulating the water supply to potentially arable areas. It has been estimated that, with proper irrigation facilities and fertilizer use, the new strains of rice will increase the yield per hectare to 10 tons compared with the normal yield of one ton in the case of local varieties produced by traditional methods. In 1969, an import duty on rice was imposed to provide further incentive for local production. It is expected that local production of rice will be able to meet domestic requirements within the next two or three years. However, an important handicap is the lack of a good communication network, so that transport of foodstuffs from surplus to deficit areas may pose a serious problem.

The Government is also encouraging the production of fish, which is the major source of protein supply for the Laotian people. A number of hatcheries have been set up in or near the large towns with the object of selling finger-lings to villages for setting up fish-ponds. In addition, a large fishery project is underway at the Nam Ngum reservoir, with an estimated production capacity of 1,500 tons of fish per annum.

With a view to improving tax collection, a national commission has been set up to revise collec-

tion methods. It is expected that the impact of the revised methods will become noticeable in the second half of 1971/72.

Since 1964, the Foreign Exchange Operations Fund has been used to support the free exchange market. The five donor countries (the United States, the United Kingdom, France, Japan and Australia) contribute in United States dollars annually and the fund is operated through the medium of commercial banks. The rate of exchange is set by the Fund Manager and the banks deal with the public at a rate varying within the range of 1 per cent around the set rate. From the beginning of 1964 until November 1971 the rate remained steady around 500 kip to US\$1. However, since heavy drawings on the Fund persisted throughout 1971, a devaluation was deemed necessary and, on 8 November 1971, the Government, after consultation with the International Monetary Fund, adjusted the free market rate to 600 kip to US\$1.

The official rate, which applies to a very limited number of transactions, has remained unchanged since 1964. The volume of foreign exchange earnings at the official rate has also been declining and the Government has introduced economy measures, such as the reduction of embassy staffs abroad, in order that foreign exchange earnings at the official rate may meet such expenditure.

Prospects

Given favourable weather conditions, the rate of growth of agricultural output may be expected to pick up again in 1972 under the influence of the various promotional measures described earlier and depending on the extension of irrigated area as the irrigation schemes progress. Laos may thus be expected to move further towards the goal of self-sufficiency in food. The increase in power-generating capacity may also encourage and facilitate the setting up of new industries and expansion of the existing ones. Exploitation of forest resources, however, may not increase significantly unless the security situation and communication network improve. The huge deficit in the balance of trade is likely to persist. Negotiations with the donor countries for commitments to the Foreign Exchange Operations Fund in 1972 were entered into and the requirements were expected to be met. Government revenues are not expected to reach the forecast level. This is primarily because the income from import duty on gold may not come up to expectation. Gold imports have been declining and the Vientiane gold market has lost its importance following the emergence of Singapore as the leading gold market. The budget deficit for 1971/72 is expected to exceed the original forecast of 9.5 billion kip by a substantial amount.

Malaysia

Introduction

The year 1970 was important for Malaysia. It was the first full year after the racial disturbances of May 1969 and the performance of the economy indicates the extent to which the economy has returned to normal. It also marked the end of the first Malaysia plan, 1966-1970, and the beginning of the second Malaysia plan, 1971-1975. Many policy changes relating to the disturbances are included in the new development plan.

Economic growth in 1970 was derived mainly from sharply increased private investment and consumption expenditures, and from the expansion of public current expenditures. Exports grew very little, largely because of lower receipts from rubber. Imports, on the other hand, rose substantially and thus the surplus on current account in the balance of payments was greatly reduced. Continuing low rubber prices were a major factor in the poorer export performance of early 1971. Economic growth in 1971 is likely to be below that of 1970.

Table II-3-18. MALAYSIA: MAIN ECONOMIC INDICATORS

	1969	1970	1971
Real GNP growth rate (%) ^a	8.0	6.1	5.0 ^b
Exports (M\$ million) ^c	4,986	5,106	2,463 ^d
Imports (M\$ million) ^c	3,505	4,186	2,074 ^d
Balance of payments ^c	530	60	252
Consumer prices (1963 = 100) (end December) ^a	105.2	106.4	105.7 ^f
External reserves (M\$ million) (end December) ^c	2,471	2,595	2,972 ^f
Money supply (M\$ million) (end December) ^c	1,911	2,058	2,105 ^g

^a Source: *Second Malaysia Plan, 1971-1975*.

^b Estimated.

^c Over-all balance, excluding monetary movements.

Source: Bank Negara Malaysia.

^d First half of 1971.

^e Source: Department of Statistics.

^f End August.

^g End September.

Recent economic developments

(a) Economic growth

In 1970, GNP, at 1965 prices, grew at 6.1 per cent, a rate substantially lower than the 8.0 per cent

of 1969 but marginally higher than the average annual growth rate of 6 per cent achieved during the first Malaysia plan period. Population growth in 1970 was estimated at 2.7 per cent, so that *per capita* real GNP went up by 3.4 per cent. This increase was again substantially smaller than the 4.8 per cent recorded in 1969, but was nevertheless significantly higher than the 2.3 per cent achieved during the first plan period. The performance of the economy during 1970 was therefore better than the performance during the whole period of the first Malaysia plan. Changes in the main economic variables in 1970 over 1969 and in relation to the period 1966-1970 are shown in table II-3-19 below:

Table II-3-19. MALAYSIA: GROWTH RATES OF GROSS NATIONAL PRODUCT AND SAVINGS AT CURRENT MARKET PRICES

(in percentages)

	1969/1968	1970/1969	Average annual growth rate 1966-1970
Consumption expenditure: . . .	4.8	9.6	6.0
Private	3.2	6.9	5.3
Public	10.7	18.7	8.3
Gross capital formation: . . .	-1.2	21.9	6.5
Private	-4.9	32.9	8.1
Public	4.7	6.1	3.9
Gross domestic expenditure . .	3.8	11.5	6.1
Trade in goods and services:			
Exports	19.1	2.0	6.7
Imports	6.3	12.4	5.6
Gross national product . . .	9.8	6.3	6.5
Gross national savings . . .	32.1	-5.5	8.7
Gross national savings/GNP . .	20.4	18.1	—
Gross capital formation/GNP . .	14.2	16.3	—

Sources: *Second Malaysia Plan, 1971-1975*; Bank Negara Malaysia, *Annual Report 1970*.

The main impetus to growth in 1970 came from the domestic sector, in contrast to the situation in 1969 when the export boom provided the stimulus. During the year, gross domestic expenditure increased by 11.5 per cent, as compared with 3.8 per cent in 1969. The growth of the domestic sector was spearheaded by private sector investment, which increased by nearly 33 per cent, as compared with the decline of 5 per cent in 1969. This was an unprecedented increase and much of it was in the manufacturing and construction industries. The Federal Industrial Development Authority (FIDA), the statutory body responsible for the industrial development

programme, was streamlined in 1969 and as a result of this administrative reform the number of approvals of new projects was considerably greater in 1970 than in 1969. The rapid increase in private investment was largely responsible for raising the investment ratio from 14.2 per cent of GNP in 1969 to 16.3 per cent in 1970. Private consumption expenditures went up by 6.9 per cent, more than twice the increase of 3.2 per cent recorded in 1969.

In the public sector, investment rose by 6.1 per cent, but consumption expenditures showed the substantial increase of 18.7 per cent. These growth rates were considerably higher than those recorded in 1969. However, development expenditures in 1970 and, indeed, throughout the period of the first plan, have fallen short of targets. In 1970, the development expenditures of the Federal Government were M\$724 million, well short of budget allocations, mainly because of the shortage of skilled personnel, the limited construction operations of the Public Works Department, and delays in project clearance and in the acquisition of sites.

Revised estimates for 1971 provide for development expenditure of M\$850 million and results for the first six months show that expenditure has been much more in line with the estimate than was the case in 1970. Domestic and foreign borrowing in 1971, the programme for which had been largely completed by August 1971, is expected to be more than sufficient to cover development expenditures. Current expenditures in 1971 are budgeted to rise by about 11 per cent over the 1970 figures.

(b) *Balance of payments*

In 1970, exports of goods rose by 2.4 per cent, a substantially smaller rise than in 1969 because of the decline in the price and the volume of rubber exported, although higher receipts from tin, palm oil and timber exports (prices of which were very favourable) largely offset this fall. The value of imports increased by 19.4 per cent, because of the sharp rise in domestic private investment and consumption expenditures, and an increase in import prices. There was little change in the traditional net deficit on services and transfers, so that the balance of trade situation was primarily responsible for the sharp decline in the surplus on current account from M\$705 million in 1969 to M\$156 million in 1970. The over-all surplus in 1970 was only M\$60 million, as compared with M\$530 million in 1969.

In the first half of 1971, merchandise exports were 2.2 per cent lower than those for the same period of 1970, largely because of continuing low prices for

rubber. Receipts from tin and iron ore exports were also well down, and increased earnings from palm oil and timber were insufficient to offset these declines. The rising trend of imports which emerged in the second half of 1970 slowed down considerably in the first half of 1971, and imports were only 3 per cent higher than those for the first part of 1970, which in turn were 28 per cent higher than those for the same period of 1969. The decline in the rate of growth of imports to a large extent reflected slow growth in consumption demands. Imports of machinery and some raw materials recorded substantial increases, an indication that private investment continued at satisfactory levels in early 1971.

Although the current account surplus has declined sharply over the past three years, Malaysia's external reserves have continued to rise because of the inflow of private foreign capital, external borrowing by the Government and the allocation of special drawing rights by the International Monetary Fund. Reserves increased by M\$124 million in 1970 and by M\$313 million in the first half of 1971, to stand at an estimated M\$2,370 million at the end of June 1971. In July 1971, they were raised by a further M\$62 million as a result of the liquidation of the third international Tin Buffer Stock.

(c) *Money and prices*

The supply of money increased by 7.7 per cent in 1970, as compared with 13.3 per cent in 1969. This slower rate of growth in the money supply is in line with the slower rate of growth of GNP. The main source of money expansion was the growth in bank lending to the private sector, especially to manufacturing enterprises. The money supply was also augmented, but to a lesser extent, by the increase in the net external reserves of the banking system. Public sector operations for the year as a whole were contractionary, although a seasonal increase in public expenditure in the last quarter had a marked expansionary influence on the money supply in that period.

(d) *Employment*

The unemployment problem in 1970 worsened. Because the labour force continued to expand at a relatively high rate and because there were significant increases in productivity in certain sectors of the economy, unemployment during the year rose to between 8 and 9 per cent. Various short-term measures, including the abolition of the payroll tax in 1971 and the restriction of the amount of overtime per worker, were introduced to increase employment openings.

Major policy changes in 1970 and 1971

The second Malaysia plan, 1971-1975, published in July 1971, reveals a number of important changes from past policies. The major objectives of development planning are a greater rate of economic growth, a more equitable distribution of income and wealth, and the creation of more employment. The plan recognizes that the contradictions among these three objectives need to be reconciled.

For example, the discrepancy between employment growth and net output growth revealed in the first plan period is now specifically taken into account in the second plan. The proportion of the increase in labour to the increase in output used in projecting employment growth in the manufacturing sector is 0.56, which is in line with experience during the first plan, adjusted to take account of policy measures designed to promote labour-intensive enterprises, such as the Investment Incentives (Amendment) Bill of July 1971, which gives relief from tax according to the number of workers employed. The move to make labour a more attractive factor of production is a major departure from past practice. Another important feature of the second plan is the weight given to a more even distribution of income and wealth and a reduction of the relative racial economic imbalance. Rural development, including in particular the establishment of agro-based processing industry in predominantly Malay rural areas, is emphasized.

Prospects for 1971 and 1972

If the balance of trade for January-June 1971 is projected for the rest of the year, it is quite possible that the over-all balance of payments on current account may be in deficit.

Rubber prices have not shown any tendency to rise in spite of the decision of the People's Republic of China to buy Malaysian rubber. The introduction of a new grade of SMR, namely the Standard Malaysian Rubber Extra Quality (SMR-EQ) which has several qualitative advantages over existing grades of SMR, has not influenced the market either. In fact, the Government had to intervene in the market with support buying. It would appear that no significant boost to foreign exchange earnings from the rubber industry can be expected in the latter part of 1971 or in 1972.

London prices for palm oil in the first five months of 1971 averaged £99.81 per ton, as compared with £92.06 per ton in 1970. However, it is felt in some quarters that such prices may not be maintained in the latter part of the year or in 1972, in view of the likely balance of supply and demand for fats and oils in general.

The possibility of a balance of payments deficit on current account in 1971 or a very small surplus has drawn the Government's attention to the traditional large deficit on the current invisible and capital accounts. The problem was raised in Parliament, and various methods of reducing the deficit are now being investigated.

Mongolia*Introduction*

In 1970, Mongolia enjoyed sustained economic and social development, and, according to official records, the year ended with over-fulfilment of several product on targets set in the fourth five-year plan (1966-1970). The data available suggest that this progress has been sustained in 1971, with a considerable rise in both agricultural and industrial production. The sectoral composition of national income continued to shift in favour of industry, whose share in national income is expected to grow from 23 to 27 per cent during the fifth plan (1971-1975). Gross fixed-capital formation increased in 1970 by 10.1 per cent and, since national income grew by 5.8 per cent, the investment ratio rose. Investment is expected to grow by 7.2 per cent in 1971 and national income by 5.3 per cent. The major strategies envisaged in the fifth plan are: a more stable and substantial growth of agricultural production, particularly within the livestock sector, together with a continuation of the country's basic industrialization strategy which maintains a higher rate of growth for capital than for consumer goods production.

Recent economic developments

In 1970, the final year of the fourth five-year plan, Mongolia's national income increased by 5.8 per cent. In agriculture, which accounts for more than half of the country's entire output and provides over 80 per cent of total export earnings, 1970 was a year of satisfactory performance. Despite adverse weather conditions, the 1970 annual plan targets for livestock-rearing were exceeded and crop production doubled to yield an output of 326,500 tons. About 40 per cent of total investment in 1970 was devoted to agriculture. For the fourth plan period as a whole, the annual average rate of growth of agricultural output was 6.1 per cent.

To increase production in agriculture during the fourth plan, the Government raised the state purchase prices for various agricultural products by 25-100 per cent. In addition, bonus prices ranging from 30 to 400 per cent above basic purchase prices were introduced for sales of cattle, sheep, wool and milk delivered to the State over and above the plan quotas.

Progress was also recorded in industry, transport, communications, health and education. In 1970, gross industrial production increased by 11 per cent. Capital goods production increased by 13 per cent, and consumer goods by 9 per cent. Growth rates were particularly high in the fuel (22 per cent), metal-working (40 per cent) and textile (24 per cent) industries. As a result, many industries over-fulfilled their 1970 annual plan targets.

The 1970 transport development targets were reported to be over-fulfilled. Emphasis was placed on the provision of telephone and other communication facilities in rural areas.

In the field of public health, statistics for 1970 show that there were 94.3 hospital beds for every 10,000 persons and one doctor for every 560 persons in the country. About 9 per cent of the national budget goes into providing free medical services. As a result of improvements in public health and the rise in living standards generally, the country's birth rate continued to increase and its death rate to fall.

Current policy issues

1971 marked the commencement of the fifth five-year plan. Real income is expected to increase by 22-23 per cent during the period. The plan envisages a continued effort to develop agriculture, whose gross output is expected to grow by 22-25 per cent. Stress will be laid on technological improvement and on improving livestock breeding.

In the past, progress in the livestock sector has been unstable and productivity has been low, mainly owing to obsolete farm management practices and technology, slowness in introducing modern scientific methods of breeding, and unsatisfactory organization of labour and other resources in the co-operatives and state farms. In the fifth plan period, 35 per cent of total investment is to be allocated to agriculture, as compared with 24 per cent in the previous period. Over 70 per cent of this will be used for the development of facilities for improved livestock breeding.

The target for industrial output is an annual growth rate of 9 per cent, with emphasis on further strengthening the fuel and power industries and on improving the quality of industrial goods. Light industry is expected to rise by 43-47 per cent and food industry output by 60-65 per cent.

In the new plan period, efforts are to be made to improve management. Material incentives to increase production and to encourage greater effort from the labour force will be accentuated. Each production unit is expected to be financially self-reliant,

and the responsibility and authority of individual enterprises in their use of materials, manpower and financial resources is to be extended. Greater emphasis is to be given to price incentives to achieve plan targets.

Foreign assistance, both financial and technical, will play a major role in the implementation of the country's fifth plan. In 1971, 44.6 per cent of total fixed-capital formation was financed from foreign sources.

Outlook for 1971/72

The short-term outlook is that Mongolia's economy is expected to continue growing at rates in excess of population growth, making possible an increase in aggregate *per capita* income levels. During 1971, the national income is scheduled to increase by 5.3 per cent and investment by 7.2 per cent.

In the short term, at least, the economy will remain predominantly agricultural, with that sector continuing to provide the major portion of exports and industrial raw materials as well as to be the major source of employment. Preliminary estimates indicate that progress in agriculture has been maintained in 1971. Meat production rose by 2.5 to 4.5 per cent and the number of young animals reared by the end of the third quarter of the year had almost reached the total for the whole of 1970.

Industrial production is scheduled to rise by about 9 per cent in 1971, but, according to preliminary data, the output of capital goods will grow by 13 per cent and that of consumer goods by 9 per cent.

National income is expected to grow by 7 per cent and investment by 5 per cent in 1972. At the same time, in line with the plan target, the growth of agricultural output is due to rise to 10 per cent, compared with the 6 per cent achieved during the fourth plan. This will require much effort on the part of farmers, in particular through the adoption of improved scientific methods of breeding and by their response to the higher prices being paid for their products. The 1972 target for industrial output is an 11 per cent increase.

The deepening of economic and technical co-operation with CMEA members, and the co-ordination of Mongolia's planned programme of development with them, is an important aspect of this country's future development strategy. The movement towards greater economic integration may be expected to have favourable effects in raising the growth of production and in helping to solve Mongolia's economic problems.

Nepal

Introduction

Nepal's economy made some progress during the last two fiscal years and prospects for 1970/71 seem to be reasonably good. During the third plan period (1965-1970), GDP at constant prices rose by 2.2 per cent per annum, a rate roughly equal to the estimated growth rate of the population. During 1970/71, the first year of Nepal's fourth plan, there occurred: a marginal decline in agricultural production; a moderate increase in industrial production; a modest decline in government revenue, especially customs; a marked rise in the general price level; a moderate increase in the money supply; and a record increase in foreign exchange reserves.

The prospects for 1971/72 appear to be more encouraging. Agricultural production is expected to increase as a result of more favourable weather conditions and continuation of government programmes aiming at increased use of improved seeds and chemical fertilizers. The new trade and transit treaty signed with India is expected to increase Nepal's international trade and industrial production as well as to restore government revenue collections, which depend largely on customs and other indirect levies, to the normal level. This, together with a comfortable reserves position and aid inflow may be expected to provide an impetus to economic development of Nepal in 1971/72.

Major economic developments

Inclement weather conditions affected the performance of the agricultural sector during 1970/71. Heavy rains during the harvesting season resulted in losses in the wheat, rice and maize crops. Preliminary estimates show that the production of wheat declined by nearly 30 per cent to 216,000 tons. Production of millet, other minor foodgrains and potatoes also suffered, while the increase in the output of paddy and maize was below expectations. An appreciable increase in production was recorded only by jute (8 per cent).

Industrial production in 1970/71, which was based mostly on local raw materials, was almost equal to the level of output in the previous year in the case of cigarettes, matches, alcohol, bricks and tiles, shoes and tea. Output of sugar exceeded the previous year's level. However, a large decline occurred in jute manufactures, a major export item, and a few other commodities were somewhat adversely affected during the period prior to the conclusion of the new trade and transit treaty with India.

Government revenue was affected both by the slowdown in the growth of the economy and uncertainty caused by delay in arriving at the trade and transit arrangements with India. Foreign loans and grants also fell short of the estimates. On the other hand, regular government expenditure increased substantially and despite a moderate increase in development outlay the deficit in the budget amounted to Rs 24.5 million.

Money supply expanded by 12.8 per cent in 1970/71 as against the increase of 9.7 per cent in the previous year. The monetary data for 1970/71 reflected a change in the trend of the fiscal and monetary operations. In 1968/69 and 1969/70 the main expansionary influence had emanated from the foreign sector, while the government sector and time deposits were the main contractionary factors. In 1970/71, however, the government sector became expansionary while the banking system's claims on the private sector showed a decline due to a decrease in bank credit for exports.

The price situation deteriorated during 1970/71. The consumer price index increased by 7.9 per cent in 1970/71 as against the rise of 3.7 per cent in the previous year. The rise was greater in the hilly region (9.6 per cent) than in the Kathmandu valley (9.5 per cent) and Terai areas (8.1 per cent). The price situation was affected by the rise in prices of goods imported from India, such as salt, oil, kerosene and textiles, since there had been periodic shortages of these commodities. The deterioration in the price situation would have been sharper but for a steeper fall in prices of domestic goods, particularly those of foodgrains, than in the previous year; domestic goods' prices fell by 7.9 per cent in 1970/71, as compared with the decrease of 3.7 per cent in 1969/70.

A balance of payments statement for Nepal has not yet been compiled: reliable statistics are lacking because 90 per cent of Nepal's trade and capital payments are with India and a large part of the transactions does not go through the banking channels. However, despite these limitations, it can be inferred from the reserves figures that the balance of payments has not been under pressure. Convertible foreign exchange holdings of the banking system increased by Rs 204.4 million (36.2 per cent) during the period mid-July 1969 to mid-July 1971. Similarly, official holdings of the Indian currency reserves increased by Rs 29.3 million (16.9 per cent) over the same period. However, in 1970/71, the official foreign exchange holdings of the banking system did not increase at the same rate as in the preceding two years due mainly to trade uncertainty because of the slow progress of Nepal-India trade and transit talks.

Recent measures

In the field of agriculture, the Government continued its efforts to expand credit facilities and irrigation and encouraged the use of improved seeds and fertilizers. Diversification, both crop-wise and regionally was pushed further in favour of jute, tobacco, sugarcane, oilseeds and cotton. Improvement in cotton yield was achieved on experimental farms run with foreign technical assistance. Raising of livestock and cultivation of citrus fruit and potatoes was promoted in the northern hilly areas and along the highways. To expand jute cultivation, a Jute Development Board was established during the year.

In the industrial sector, a two-year crash programme within the policy framework of the fourth five-year plan was initiated, and the Government published a priority list of industries. With a view to encouraging private investment, certain industries, such as food-processing, forest-based industries, other consumer goods industries and hotels for tourists, were granted special privileges. An Industrial Licensing Board was created and an Industrial Services Centre was established to undertake feasibility studies of new industries on a continuing basis. A Small Industries Development Corporation was also set up to provide technical and financial assistance for local handicraft and other small industries using domestic raw materials.

A new treaty on trade and transit was signed with India in August 1971 covering a period of five years. The treaty provides for most-favoured-nation treatment on a reciprocal basis and also for the extension of certain preferences by India on a non-reciprocal basis. The transit arrangements for Nepal's exports via India were also liberalized.

Co-ordination between planners and executing agencies is being brought about and regional plans have been initiated with a view to achieving regional balance. The Remote Areas Development Committee set up in 1969 is conducting techno-economic surveys of the northern districts and the Small-Scale Industries Development Corporation, established in 1971, is concentrating its first efforts on the relatively less developed areas.

Prospects for 1971/72

The prospects for the economic performance of Nepal during 1971/72 are encouraging. Agricultural production is expected to improve on the assumption of more favourable weather conditions. Industrial production is also likely to pick up as the uncertainties about trade and transit arrangements have disappeared after the conclusion of the new treaty and

a freer flow of imports and exports has been assured. The import of industrial inputs can be liberalized as the reserves position is comfortable. The forecast of government revenue for 1971/72 stands 24 per cent higher than the revised figure for 1970/71. Foreign loans and grants are expected to rise by 43 per cent over the level reached in 1970/71. Development expenditure is estimated to rise by 57 per cent, while the increase in ordinary expenditure will be only 11 per cent. Deficit financing is likely to be somewhat higher than last year. However, the utilization of accumulated foreign reserves (which are sufficient to finance as much as one year's imports at the current rate), besides aiding the development process, could dampen the rising price level.

New Zealand

Introduction

During 1971, there has been a gradual reduction in the rapid rate of increase of wages and prices which characterized the latter part of the previous year. The problems of inflation have been approached from the demand side by restrictive fiscal and monetary policies; from the supply side, by some relaxation of import controls and by imposing some direct restrictions on the increase of prices and remuneration. The improvement in economic stability and in the balance of payments has been achieved at the cost of a slackening in the growth of output and investment, and the Government is now seeking a combination of policies which will give renewed stimulus to growth, especially of exports, without reversing the progress being made in reducing inflation. Domestic inflation over the past two years and the worsened terms of trade are two of the more important factors that affected the full-scale revision of national development targets in November 1971.

Recent economic developments

(a) National income and expenditure

Table II-3-21 summarizes the developments which have been occurring in national income and expenditure. The most striking feature of the year ended March 1971 was the sharp increase in wages and salaries, which gathered considerable momentum in the latter part of that year. As a result of direct controls over remuneration, of slacker economic activity, and of a reduction of labour shortages, the pace of increase has fallen markedly in 1971. However, the New Zealand Institute of Economic Research has forecast that total salaries and wages in the year ending March 1972 will be about 17.5 per cent higher than they were in 1970/71. More than half of this

Table II-3-20. NEW ZEALAND:
MAIN ECONOMIC INDICATORS

	1968	1969	1970	1971
Real GNP growth rate (%)	-0.4	1.6	4.7	5.5
Exports, NZ\$ million	750	974	1,112	1,109
Imports, NZ\$ million	637	721	826	1,039
Balance of payments, NZ\$ million	-88	+39	-19	-202
Consumer prices, 1965=1,000 (calendar years)	1,137	1,193	1,271	1,374 ^a
External reserves (end of June) NZ\$ million .	302	325	345	460 ^a

Source: Various official publications.

Note: Years ending in March.

^a First half 1971.

increase is attributed to the large increases in pay which occurred towards the end of the previous year, but wage rates are continuing to rise by more than the Government's general guideline maximum of 7 per cent.

Domestic expenditure rose even more rapidly than incomes in 1970/71, indeed by about 19 per cent over-all, with particularly large increases in private capital formation and in the labour-intensive government services. In the current year, the growth of the private sector's investment expenditures has slowed appreciably, and they have probably fallen in real terms; at the same time, the Government has been restraining the growth of employment in the public service and deferring some capital works. The growth of total domestic outlay in 1971/72 is expected to be about 12 per cent, much lower than in the previous year.

(b) Output, prices and wages

In 1970/71, output probably rose in real terms by 4 per cent or 4.5 per cent with farm output restricted by adverse climatic conditions. The increase in 1971/72 will almost certainly be slower.

Price increases in the past two years have been substantial; the peak rate of increase occurring towards the end of 1970, and the rate slackening throughout 1971. This is reflected in the quarterly changes in the consumers' price index. This index rose by a disturbing 4.1 per cent in the last quarter of 1970; the increases in the succeeding three quarters have been 2.5 per cent, 2.2 per cent and 1.9 per cent respectively, a reflection of the price freeze imposed between November 1970 and February 1971 and of the price justification scheme for a range of key commodities that followed. A Stabilization of Remuneration Act was introduced early in 1971, estab-

lishing a Remuneration Authority whose approval must be sought for proposed increases in remuneration over a guideline figure of 7 per cent above rates paid on 1 January 1971. The Authority can approve increases above the guideline on various grounds and has done so. The controls have accordingly not prevented a rate of growth of pay substantially above the 1960-1969 average of 4.9 per cent per annum; nevertheless, they are unpopular with most unions. The Act is seen as a temporary expedient for use while a more satisfactory wage bargaining framework is being evolved but negotiations on this have proceeded slowly.

(e) External trade and payments

The large increases in domestic expenditure in 1970/71 were reflected in a substantial growth of imports and the balance of payments on current account swung from a surplus of about NZ\$20 million in the previous year to a deficit of over NZ\$200 million. With the slackening of domestic activity and investment in the current year, and some improvement in the growth of export receipts, this deficit has been rapidly reduced, and is projected to be not much more than NZ\$100 million in the year ending March 1972.

A notable feature of the past year has been a big net inflow of capital from abroad. For the year ended September 1971, this totalled nearly NZ\$117 million (of which NZ\$75 million was on private account and NZ\$42 million official capital), as compared with only NZ\$23 million in 1970. These developments and the receipt of more special drawing rights from the IMF have produced a most significant improvement in the country's official overseas reserves during the year. At the end of September 1971 these exceeded NZ\$500 million, the equivalent of nearly six months' payments for imports.

Table II-3-21. NEW ZEALAND: INCOME AND EXPENDITURE

(in million New Zealand dollars)

March years	1969/70 actual	Change (%)	1970/71 estimated	Change (%)	1971/72 estimated
Salaries and wages	2,535	21.5	3,075	17.5	3,620
Farming income	287	4.5	300	10	330
Company income	577	8.5	625	9	680
Other private income	877	7	940	9	1,025
Private income	4,274	15.5	4,940	14.5	5,655
Public authority trading income . .	207	-10.5	185	8	200
Less: Government transfers to persons .	-447	9.5	-490	11	-545
National income	4,034	15	4,635	14.5	5,310
Indirect taxation less subsidies . . .	352	16.5	410	13.5	465
Depreciation	371	8	400	9	435
GNP	4,757	14.5	5,445	14	6,210
Consumption expenditure					
Private	2,881	16.5	3,360	14.5	3,850
Public	729	20.5	880	12.5	990
Fixed capital formation					
Private	617	23	760	6.5	810
Public	388	13.5	440	10	485
Change in stocks	120	—	205	—	185
Domestic outlay	4,735	19	5,645	12 [▲]	6,320
Balance of payments	22	—	-202	—	-110
Expenditure on GNP	4,757	14.5	5,445	14	6,210

Source: New Zealand Institute of Economic Research, *Quarterly Predictions*, September 1971.*Developments in economic policy**(a) Fiscal and monetary policy*

For 1971/72, the Government budgeted for a rise in expenditure of about 10-11 per cent, as compared with that of 18 per cent in the previous year. In fact, expenditure has been rising more rapidly than expected, largely due to substantial pay increases accorded to civil servants. In the first six months of the fiscal year, total government expenditure was probably about 12 per cent higher than in the same period in 1970. However, revenue especially from income and payroll taxes rose even more rapidly in the same period, probably by over 20 per cent, mainly as a result of measures taken in 1970. The Government therefore felt able to remove from August the temporary surcharge of 10 per cent on income tax imposed in October 1970.

The Government has continued during most of 1971 to set fairly restrictive ceilings on the growth of bank advances to borrowers not in the preferred export categories, the general aim being to confine the total increase to about 9 per cent above the previous year's level. Recently, however, this policy has been relaxed so that advances may now be permitted to rise to levels about 11 per cent higher during the year ending June 1972 by comparison with the previous year. Other measures aimed at some easing in the supply of credit to the private sector (especially mortgage finance) have also been taken.

(b) Import and export policies

Further relaxations in import and exchange controls were announced in the 1971 Budget Statement.

Restrictions on remittances of legacies and by end-grants were removed, travel allowances were increased substantially and restrictions on the export and import of bank notes were relaxed. Import licensing on materials and equipment, especially motor cars, was further reduced and the Government stated its intention to replace most of the remaining import controls by tariffs as the main measure of protection within the next five years and has announced a substantial list of products for consideration for delicensing in the first year.

On export policy, the most important development during the year was the agreement reached in June between the United Kingdom and EEC on the principles of a special arrangement for New Zealand. In essence, this provides for the gradual scaling down of guaranteed access to the British market for New Zealand butter and cheese during the five-year transitional period from 1 January 1973. But New Zealand will still be able to sell 80 per cent of present quotas for butter in 1977, whereas the guaranteed cheese market will have fallen to 20 per cent by that time and will be phased out completely in the following year. Arrangements for butter after 1977 are to be the subject of negotiation in 1975. The minimum prices to be paid for the guaranteed quantities are to be the average of those prevailing between 1969 and 1972.

While the Government has expressed some reservations about the equity of this arrangement on prices, it has accepted the remainder of the arrangements made as reasonably satisfactory in the circumstances.

New Zealand has not so far been greatly affected by the developments in international trade and finance caused by the balance of payments problems of the United States. Being already subject to quota, several of its exports were exempt from the 10 per cent surcharge. The rate of exchange of the United States dollar in relation to the New Zealand dollar is now 84 NZ cents as compared with the former rate of 89 NZ cents.

Prospects for 1972

Although cost inflation has dissipated many of the advantages which the 1967 devaluation brought to the country's export industries, higher export prices and a slowing down of growth in imports means that the immediate outlook for the balance of payments is for continuing improvement.

The main problem of policy remains the potential conflict between the requirements to induce greater expansion of investment, output and exports, and the need to continue to reduce the inflation of

costs and prices. The indications are that the Government will cautiously continue to relax restraints on credit and to ease its restrictive fiscal policy, with major emphasis being placed on concessions which will assist exports and investment. With the acknowledged inadequacy of present incomes policies, the Government is likely also to continue to press for agreement with the major organizations of workers and employers on establishing a new basis for bargaining about pay and other conditions within a framework of rules designed to protect the public against a further resurgence of the cost inflation that has occurred in the past two years.

Pakistan

Introduction

A combination of adverse factors affected Pakistan's economic performance in 1970/71. A severe cyclone and floods in the east of the country and drought conditions in the west caused a sharp reduction in agricultural output. Foreign exchange shortage necessitated checks on imports, and the resultant scarcity of imported raw materials and spare parts curtailed the rate of growth of industrial production. Private investment in real terms fell on account of uncertainties, labour unrest and other factors. Tax receipts and foreign assistance failed to reach the estimated level, while non-development expenditure of the Government increased on account of relief and law and order operations. The tempo of development expenditure could not be sustained. Savings declined more steeply than over-all fixed investment. The balance of payments recorded a large deficit. The slowdown in investment activity appears to have worsened the employment situation.

Though agriculture in 1971/72 is expected to stage a recovery on account of more favourable weather conditions and supportive measures, industrial production may remain depressed owing to the scarcity of imported raw materials which is likely to persist. The GNP growth rate may be somewhat between last year's depressed level and this year's target.

Major development in 1970/71

The annual plan for 1970/71 aimed at a development outlay of Rs 6,980 million (net) in the public sector and Rs 4,500 million in the private sector. Tentative evaluation showed that actual implementation, in terms of current prices, was of the order of Rs 5,570 million in the public sector and Rs 4,910 million in the private sector, showing a decline of 10.5 per cent in the former and an improvement of

Table II-3-22. PAKISTAN:
MAJOR ECONOMIC INDICATORS
(percentage changes)

	1969/70 actuals	1970/71 estimates	1971/72 projections
GNP ^a	6.6	1.4	5.0-5.5
Money supply ^b	9.7	8.4	—
Merchandise exports ^c	1.0	-0.7	8.5 ^d
Merchandise imports ^c	4.1	1.6	4.0 ^d
Foreign exchange reserves (million rupees)	1,368 (end June 1970)	949 (end June 1971)	—
Consumer price index ^e	4.9	4.0	—

^a At 1959/60 factor cost. *Source*: Central Statistical Office, *Monthly Bulletin*, October 1971, p. 1089 and *Budget in Brief*, Ministry of Finance, Government of Pakistan, 1971, p. 15.

^b *Source*: State Bank of Pakistan, *Annual Report for 1970-1971*, pp. 11-12. The figure for 1970/71 is for the period July 1970 - 4 June 1971 and that for 1969/70 is for the corresponding period.

^c *Source*: Central Statistical Office, *Monthly Bulletin*, October 1971, p. 1051. Figures for exports are exclusive of re-exports.

^d *Source*: *Annual Plan for 1971-1972*, Planning Commission, Government of Pakistan, pp. 17-18.

^e Average of consumer price index for industrial workers at four urban centres. *Source*: State Bank of Pakistan, *Annual Report, 1970-1971*, pp. 19-20. Figures are provisional.

7.3 per cent in the latter as compared with 1969/70. There was thus a net decline of about 3 per cent in over-all gross fixed investment. In real terms, however, the decline was steeper because a sharp increase in the prices of investment inputs in the international and domestic markets and an increase in wage rates pushed up the cost of investment in current prices during 1970/71.¹ In terms of constant 1969/70 prices, private investment is estimated to have fallen by 2.6 per cent.²

As regards the source of funds, the fall in domestic savings imposed a serious constraint; at current prices, these declined by 6.7 per cent in 1970/71 as compared with 1969/70.³ Estimates of public savings went widely off the mark. Government revenue collections was badly affected on account of natural calamities and disturbances, disruption in inter-wing trade, and a slowdown in economic activity. Central and provincial revenues, taken as a whole, were estimated to have fallen short of the budget estimates for 1970/71 by Rs 1,187 million or by about 11 per cent despite the levying of additional mid-year taxes of Rs 162 million for the rehabilitation of the cyclone affected people. On the other hand, non-development expenditure exceeded the budget

figure by Rs 407 million⁴ or about 5 per cent, largely due to flood and cyclone relief, defence, and subsidy on inter-wing PIA travel. The Government had recourse to deficit financing of the order of Rs 1,468 million, exceeding the officially estimated "safe limit" by as much as Rs 868 million. In addition, the Government drew on its cash balances by Rs 162 million. However, despite this inflationary financing (which the Government must have resorted to rather reluctantly in view of the fourth plan's major objectives of price stability and social justice), domestic resources fell short of the budget forecast by Rs 457 million.⁴

Project aid disbursements in the public sector were only Rs 735 million as against the budget estimate of Rs 1,285 million; the shortfall being mainly due to a lack of complementary domestic resources. In addition, there was a considerable shortfall in rupee generating non-project aid and releases from PL 480 counterpart funds. Total foreign assistance at Rs 2,297 million fell short of the budget forecast for 1970/71 by Rs 953 million.⁴

The growth rate of the economy fell sharply during 1970/71. According to the preliminary estimates, GNP (at constant factor cost of 1959/60) increased by only 1.4 per cent in 1970/71 as against the annual plan target of 6.5 per cent and actual

¹ See *Annual Plan, 1971-1972*, op. cit., p. 2.

² *Ibid.*, p. 21.

³ *Ibid.*, p. 2.

⁴ *Ibid.*, p. 13.

growth rate of 6.6 per cent in 1969/70. Taking into account the estimated increase of 2.7 per cent in the population, *per capita* GNP declined by 1.3 per cent.⁵

Money supply during the period July 1970 to 4 June 1971 expanded by Rs 1,787.3 million or by 8.4 per cent as against an increase of 9.7 per cent in the corresponding period of 1969/70.⁶ The expansion in money supply was caused mainly by the budget deficit, while a smaller expansion took place on account of private sector borrowings as compared to 1969/70. This was attributable mainly to the slackening in business activity that emerged in the latter half of 1970/71 in the wake of post-election uncertainties and disturbed conditions. On the other hand, the foreign sector exercised a much larger contractionary influence than in 1969/70.

On 8 June 1971, Rs 500 and Rs 100 notes were removed from circulation demonetizing about 18 per cent of the total notes of these denominations in circulation.⁷ Over the year as a whole, therefore, the net increase in money supply has been substantially less than indicated by the above figure.

The impact on prices of the increased disparity between the rates of increase of output of goods and services and money supply during 1970/71 was less marked than might have been expected. The consumer price indices at various urban centres rose by an average of slightly over 4 per cent as against the rise of about 5 per cent in 1969/70.⁸ This is perhaps explained by the satisfactory supply of food-grains and the relative stability of their prices.

The pressure on the balance of payments increased during 1970/71. Over-all export earnings remained stagnant, imports, on the other hand, increased by 1.6 per cent⁹ despite measures to reduce them. Invisible earnings also declined mainly because of the fall in home remittances by Pakistanis working abroad. Preliminary data showed that the balance of payments recorded a deficit of Rs 544.9 million in 1970/71 as compared with the deficit of Rs 184.3 million in 1969/70. The gold and foreign exchange reserves, without taking into account the second allocation of SDRs amounting to Rs 119.7 million, declined by Rs 538.9 million.¹⁰

Policy issues and recent measures

One of the basic objectives of the fourth five-year plan (1970-1975) is to reduce inter-personal and inter-regional disparities. In pursuance of this objective, additional tax measures, estimated to yield about Rs 400 million, were introduced in the budget for 1970/71 to affect the cost of living of high income groups, mostly via sales tax and excise duties on items figuring prominently in their cost of living. In addition, an income tax surcharge, estimated to yield another Rs 162 million was imposed in January 1971 to meet the rehabilitation expenditure in areas affected by the cyclone. Some progress was made, therefore, in the direction of placing a greater tax burden on the higher income groups.

As regards the objective of reducing inter-regional disparity, the annual development programme in the public sector for 1970/71 originally fixed at Rs 7,700 million (gross) provided for a higher share for the eastern part of the country — Rs 4,150 million as against the western region at Rs 3,550 million. Final figures about actual implementation are not yet available, but estimates show that there was a larger shortfall in the east due to the impact of floods, the cyclone and other disturbances.¹¹ The annual development programme for 1971/72 which has been placed at Rs 5,500 million (gross) had also provided a larger allocation for the eastern wing (Rs 2,790 million — including Rs 300 million for flood control schemes and Rs 100 million for the cyclone affected areas) than to the western part (Rs 2,710 million — including Rs 700 million for the Indus Basin Project). In addition an allocation of Rs 150 million was made for repair of damage caused to transport and other facilities during the disturbances.¹²

The Government incorporated in the budget for 1971/72 a number of measures recommended by the Taxation Commission.¹³ Important among these were: (1) reduction of personal allowance in the case of non-salaried income; (2) lowering of the investment allowance; (3) reduction of perquisites provided by companies to their employees (4) discontinuation of the 15 per cent rebate on profits distributed by public companies; (5) imposition of a tax on undistributed profits; (6) suspension of tax holidays; and (7) lowering of the exemption limit in the case of estate duty, wealth tax and gift tax. Additional taxation from these and other sources is estimated to yield Rs

⁵ Central Statistical Office, *Monthly Bulletin*, October 1971, p. 1089.

⁶ See *Annual Report, 1970-1971*, State Bank of Pakistan, *op. cit.*, pp. 11-12. Money supply figures were not available after 4 June 1971.

⁷ *Ibid.*, pp. 51-52.

⁸ *Annual Report for 1970-1971*, State Bank of Pakistan, *op. cit.*, pp. 19-20.

⁹ See Central Statistical Office, *Monthly Bulletin*, October 1971, p. 1.

¹⁰ State Bank of Pakistan, *Annual Report for 1970-1971*, p. 22.

¹¹ See *Pakistan Economic Survey, 1970-1971*, *op. cit.*, table 84, p. 159.

¹² *Budget Speech, 1971-1972*, Ministry of Finance, Government of Pakistan, p. 6.

¹³ See *Interim Report of the Taxation Commission*, Government of Pakistan, 1971.

536 million during 1971/72.¹⁴ The budget for that year also provides for a reduced level of deficit financing — Rs 360 million as against actual deficit financing of Rs 1,468 million in 1970/71.

In the monetary field, certain credit curbs were imposed in January 1971 following an excessive busy season expansion in bank credit to the private sector. Thereafter, bank credit started declining and this trend was accentuated by the influence of the slack season. The State Bank of Pakistan, therefore, withdrew the new restrictions in March 1971; and, in September 1971, the quota system,¹⁵ designed to raise the effective lending rate, was abolished.

Export promotion measures have been given high priority. In July 1970, a 10 per cent bonus was allowed on exports of raw jute and raw cotton and the bonus entitlement on raw jute was subsequently raised to 15 per cent. In the case of manufactured exports, the bonus rates were raised from 30 and 40 per cent to 35 and 45 per cent. The new Industrial Investment Schedule reserved the bulk of new investment for export industries and a programme was formulated to increase exports by Rs 1,500 million in the next three years. An export credit fund was established in the State Bank of Pakistan with an initial capital of Rs 20 million to meet the requirements of those sectors of the export trade in which extension of medium- and long-term credit is usually a necessary condition of sale, and also to provide refinancing facilities to banks at a concessional rate against pre-shipment credits.¹⁶ With a view to protecting the competitiveness of Pakistan's exports following the floating of the US dollar, the Government unlinked the rupee from sterling and aligned it with the dollar as from 17 September 1971. The effect of 10 per cent import surcharge imposed by the United States was not substantial, for the surcharge affected only 15 per cent of Pakistan's exports to the United States market, the bulk of exports being already covered by quantitative import restrictions. The official parity rate of the rupee in terms of US dollar was not altered following the realignment of exchange rates on 19 December 1971. The effective devaluation of the rupee *vis-à-vis* the Japanese yen and some European currencies is likely to have a favourable impact on Pakistan's exports.

In view of the heavy pressure on the balance of payments, import of all items considered as luxuries, including motor cars, was banned in the January-June 1971 shipping period; and, in April 1971, all

imports for which licences were being issued on a cash basis (i.e. at the official exchange rate) were shifted to the cash-cum-bonus list, while the previous cash-cum-bonus list was suspended, with some exceptions. Aid-giving countries were approached in April 1971 to postpone conversion of that part of debt servicing which arose out of bilateral aid commitments. This arrangement became effective from 1 May 1971. Payment, however, continued to be made in special rupee accounts on due dates. Debt service payments relating to commercial transactions were not affected by this arrangement.¹⁷

To relieve unemployment, the Government decided to establish a special fund with a capital of Rs 30 million that will provide loans to technically qualified persons to establish small enterprises. A Bureau of Emigration was also set up to promote export of labour on a planned basis.¹⁸

Outlook for 1971/72

The strategy adopted for 1971/72 seeks to concentrate upon more labour-intensive sectors and projects. Agriculture has been given a high priority. In the east of the country, special emphasis was placed on the rural works programme to improve the rural employment situation and to increase purchasing power; in the west, measures are being taken to improve crop intensity through expanded tubewell irrigation.¹⁹

The target for GNP growth rate has been set at 5.0 to 5.5 per cent for 1971/72. It comprises broad sectoral growth targets of 4 per cent in agriculture, 7 per cent in manufacturing and 6 per cent in services.²⁰ Though these targets are higher than the achievements in 1970/71, they are modest when compared to the performance in the third plan period. The target for the agricultural sector appears to be realistic and might even be exceeded as weather conditions have been more favourable than last year and fertilizer consumption is picking up again.

It appears, however, that due to the disturbed conditions in 1971, output, particularly in the industrial and other sectors, may not be significantly higher than it was last year. The restricted aid inflow coupled with the take-over of the management of certain basic industries by the Government in January 1972 may tend to slow down investment activity. As a result, the performance of the construction sector

¹⁴ See *Budget Speech, 1971-1972*, op. cit., pp. 14-22.

¹⁵ See *Annual Report for 1970-1971*, State Bank of Pakistan, op. cit., p. 18.

¹⁶ *Budget Speech, 1971-1972*, op. cit., p. 5.

¹⁷ *Ibid.*, p. 3.

¹⁸ *Ibid.*, p. 11.

¹⁹ *Ibid.*, pp. 10-11.

²⁰ *Budget in Brief*, op. cit., p. 15.

may also be affected adversely. Industrial production depends considerably on the availability of foreign exchange to finance the import of raw materials and spares and is, therefore, linked with the export performance. Though exports were reported to be doing well up to October 1971, it may be difficult, in view of the events that followed, to achieve the annual plan target of 8.5 per cent growth rate for exports. A significant import liberalization may, therefore, not be feasible and industrial inputs are likely to remain scarce. As for the trade and commerce sector, the disruption of the transport system seems to have hindered its growth. The over-all growth rate of GNP may, therefore, be around 3 per cent, indicating stagnation in *per capita* income.

Papua and New Guinea

Introduction

The annual rate of growth of GNP in the monetized sector of the economy of Papua and New Guinea in the two fiscal years ending 1971 averaged 25.3 per cent. This high rate of growth was due to the development of the copper mining operation at Bougainville, which is estimated to have accounted for 24.1 per cent of GNP (monetized sector) in 1970/71. However, the subsistence sector remains of great importance, as is indicated by the fact that, in 1966, subsistence and non-market income was officially estimated at just under US\$100 per head of *total* population.

The country adheres to the Australian monetary system and receives unrequited transfers from the Australian Government in the forms of spending by Australian government departments and of a direct subsidy to the Administration. The value of these

transfers rose over the last decade from A\$37 million in FY 1960/61 to about A\$150 million in FY 1969/70, amounting in the latter year to nearly US\$70 per head of population.

Recent economic developments

(a) Rates of growth

As indicated in table II-3-23, the rate of increase in the growth of GNP accelerated between FY 1968/69 and FY 1970/71.

Growth from 1968/69 to 1969/70, an interval covering the period when construction began on the Bougainville copper mining project, is likely to be the highest for some time to come. However, the growth rate over the following annual period was also very high. A slight fall in output of the monetized sector is expected in 1971/72 because of a lag between the completion of construction activity and the beginning of copper sales. From 1972, the levels of national and domestic product and their rates of growth will, of course, be considerably affected by world copper prices.

(b) Prices and wages

No satisfactory consumer price index has been devised, but the index used suggests that consumer-price inflation has not been a problem, the index rising from 100 in 1961/62 to 119 in 1970/71.

Minimum urban wages in several towns were increased in 1969 and 1970, generally by A\$0.50 per week to about A\$7.00, and a rise in rural minimum wages from the equivalent of about A\$4.50 per week to A\$6.00 per week, has also been recommended.

Table II-3-23. PAPUA AND NEW GUINEA:
ANNUAL RATES OF GROWTH AT CONSTANT PRICES
(in percentages)

	From official figures		From unofficial projections		
	Average 1965/66- 1968/69	1969-1970	1970-1971	1971-1972	Average 1969/70- 1974/75
GDP at market prices (monetized sector) . . .	13.5	32.1	25.3	-1.5	13.7
GNP at market prices (monetized sector) . . .	13.6	33.8	22.7	-0.6	9.9
GDP at market prices (including non-market sector)	6.9	17.7	—	—	—

- Sources: 1. Papua and New Guinea, Office of Programming and Co-ordination, *The Development Programme Reviewed*, Port Moresby, August 1971, pp. 7, 10.
2. M. L. Treadgold, "Projections of Economic Activity in Papua and New Guinea with Special Reference to the Bougainville Copper Project", mimeo., Research School of Pacific Studies, Australian National University, September 1971, pp. 43, 45.

(c) *Agricultural and manufacturing performance*

Coffee and tea sales in 1969/70 were somewhat higher than projected two years earlier and those of cocoa and coconut products somewhat lower. Copra sales were lower than in the previous fiscal year. Tea and coffee output has continued to expand. Exports of coffee in 1969/70 had almost doubled in volume and value since three years earlier. Rubber production was substantially lower (12.6 per cent) in 1969/70 than in the previous year. Developments in the area planted in cocoa, tea and rubber have slowed down with particularly marked lags in indigenous plantings of tea and rubber. Returns from cocoa, rubber and copra exports have all been affected by falling export prices in recent years. Forest production in 1969/70 was almost up to the 1968 programme projections in terms of value and the timber industry may well be more important commercially than any individual tree crop by 1974/75.

Over the three years to 1969/70, the rate of growth of gross manufacturing output was about 15.4 per cent. While "food, drink and tobacco" have grown roughly as anticipated, "engineering" and "timber processing" have grown faster, and "other industries" markedly slower than expected.

(d) *Balance of payments*

Because of the special monetary status of the country, the balance of payments is a matter of little immediate concern. Deficits on current account in recent years (excluding unrequited transfers) of about A\$100 million have been covered largely by subsidies and capital inflow from Australia. Following the start of construction on the Bougainville project in 1969/70, imports and invisible expenditures increased much faster than exports and invisible receipts. The current account deficit for 1969/70 is estimated at A\$159.9 million. Other contributory factors to increased import demand have been the 22 per cent rise in official Australian government and mission subsidies and loans and the 140 per cent rise in foreign private investment.

For the first five months of 1970/71, visible imports increased in value by 29.3 per cent over the corresponding five months of the previous year and a deficit on current account (excluding transfers) of A\$258.9 million has been unofficially projected for the year.¹ The current account deficit is expected to be somewhat smaller in 1971/72 because of the normal increase in exports and a fall in imports of goods and services on account of the copper project.²

¹ Treadgold, *op. cit.*, p. 34.

² Treadgold, *ibid.*

Major policy changes in 1970 and 1971

The period since 1968 has been marked by a steadily increasing official concern for localization of employment and participation of Melanesians in business.

This concern has been expressed recently through the expanding proportion of Development Bank lending that goes to indigenous entrepreneurs, through an ever-increasing variety of government training services, through government assistance to private training programmes and through the appointment of indigenous officers to senior positions in the public service.

Most important, perhaps, of the policy developments was the transfer of powers announced by the Australian Prime Minister in July 1970 by which a number of areas of government came entirely under the control of the House of Assembly and Administrator's Executive Council in Port Moresby.

Prospects and policy measures required

Of the major international economic events of 1971, the currency crisis can be expected to have little impact on the Papua and New Guinea economy. Nor is British entry to the European Economic Community likely to affect Papua and New Guinea's exports to any significant extent. A more worrying problem is that, with rising exports of coffee — its most important cash crop from predominantly indigenous holdings — Papua and New Guinea may have to face a quota under the terms of the International Coffee Agreement.

Even more important than this and other international complications is a combination of domestic, political and economic changes: on the one hand, the possibility of large-scale developments of natural resources which have given the country's development a completely new aspect, and, on the other, the hurried preparation for self-government and independence.

The question of economic relations with Australia will also have to be considered before very long. Large natural resource projects may reduce the need for Australian financial aid; though with the critical shortage of trained manpower there will be a need for continued technical assistance in spite of the progress being made in training indigenous personnel.

The prospective "major projects", insofar as they eventuate, will bring great bonuses; but a major task that they will impose is that of redirecting much of the proceeds so that they open opportunities for all.

The Philippines

Introduction

The year 1971 has been one of recovery for the Philippines after the economic adjustments, set in motion early in 1970, to deal with internal inflation and external imbalance. These adjustments included the *de facto* devaluation of the peso in February 1970, curbs on monetary expansion and fiscal action to reduce the Government's budget deficit and a restructuring of the foreign debt. As a result of a sharp rise in exports and a fall in imports, the balance of payments deficit on current account has been substantially reduced. Production in the first half of 1971 recovered in almost all sectors; the government accounts in 1970 and 1971 have moved from a large deficit cash position to one of comfortable surplus. Rising prices remained a problem, but the rate of increase showed signs of slowing down in the latter part of 1971. The better performance of the economy has enabled the Government to revise upwards the development plan targets for 1972-1975.

Table II-3-24. THE PHILIPPINES:
MAIN ECONOMIC INDICATORS

	1969	1970	1971
Gross national product growth rate (constant 1967 prices) %	6.7	5.0	6.5 ^a
Exports f.o.b. US\$ million . .	854.6	1,061.7	538.9 ^b
Imports f.o.b. US\$ million . .	1,131.5	1,090.2	546.0 ^b
Money supply — growth rate %	23.6	18.2 ^c	15.6 ^c
Consumer prices — growth rate % (Manila)	1.5	8.3 ^c	19.8 ^c

Source: Various national official publications.

^a Preliminary.

^b 1st half 1971.

^c Years ended June.

Recent economic developments

(a) Economic growth and output

Gross national product (at constant 1967 prices) in 1970 expanded by only 5.0 per cent by comparison with the 6.7 per cent rise in 1969 over 1968. The slowdown in output was particularly marked in the second half of 1970, GNP being only 1.2 per cent greater than that of the first half of the year.

The slowdown in growth in 1970 extended to many sectors of the economy. Manufacturing growth

slackened, from 6.6 per cent in 1969 to 5.9 per cent in 1970 (at constant 1967 prices). Construction experienced the biggest cut from a 5.6 per cent rise in 1969 to a decline of 24.4 per cent in 1970. Fortunately there were slight increases in growth rates in agriculture (from 4.4 per cent to 4.6 per cent) and commerce (from 5.4 per cent to 5.9 per cent) and a continued expansion in mining and quarrying from 13.0 per cent in 1969 to 17.6 per cent in 1970.

In the first half of 1971 the economy staged a sharp recovery. Gross national product at constant 1967 prices rose to 16,959 million pesos, an increase of 5.4 per cent on that for the second half of 1970. Among the leading sectors were mining, on which output increased by 7.9 per cent; construction by 5.8 per cent; services by 4.3 per cent, and manufacturing by 3.8 per cent. For 1971 as a whole preliminary estimates indicate a rise in GNP of 6.5 per cent.

Though agricultural production as a whole recovered in the second half of 1970 from the decline experienced in the first half of the year, the production of rice has been disappointing and shortages have appeared in 1970/71. After three years of rice self-sufficiency and even of surplus as a result of the new rice technology, weather conditions in 1970/71 and political influences in one of the main growing areas, dealt severe blows to rice production. The problem was compounded by the underestimates of crop damage, but when the Government realized the magnitude of the shortage, rice imports were arranged.

Output of major export crops, especially copra, sugar, abaca and tobacco, rose sharply in the 1970 crop year, but logs and lumber fell back. Further increases of 7-10 per cent were recorded in 1971 for copra, sugar and abaca but tobacco, logs and lumber production fell, the latter by 38.6 per cent to just over half the output level of 1969. Most food crops showed increased output in 1971, but, on the whole, rates of increase were well below those recorded in 1970.

(b) Foreign trade and the balance of payments

The marked improvement in the balance of payments is one of the notable features of the Philippine economic recovery. Exports increased from US\$854.6 million in calendar year 1969 to US\$1,061.7 million in 1970, a rise of 24.2 per cent. By comparison, exports during the 1960s were expanding by 4.8 per cent per annum on average. In the first nine months of 1971 the rate of growth slowed down, especially in the third quarter, but at US\$847.7 million, ex-

ports were 9.9 per cent above the total of US\$771.5 million for the corresponding period of 1970.

Nearly all this increase was accounted for by increased earnings of the ten major exports, especially logs and lumber, sugar and coconut products. The major factors involved were the expansion in local production, buoyant demand and favourable world prices, the devaluation of the peso and the effect of export incentives.

On the other hand, imports have been held down by a combination of monetary curbs and exchange controls by the Central Bank, informal controls by the commercial banking sector and by the effect of the devaluation of the peso in raising the cost of imports. Thus, while, in 1969, imports were US\$1,131.5 million, they fell by 3.8 per cent in 1970 to US\$1,090.2 million. The deficit in the balance of payments on goods and services account was accordingly reduced from US\$283.2 million in 1969 to US\$33.8 million in 1970 and the basic balance (after allowing for private and official capital movements) which showed a deficit of US\$136.5 million in 1969 turned to a surplus of US\$20.9 million. The improvement continued into 1971. Exports rose in the first nine months by 9.9 per cent, reaching US\$847.7 million by comparison with US\$771.5 million in the corresponding period of 1970. Imports, on the other hand, also rose by about 9 per cent. Much of this increase, by comparison with the performance in 1970, took place in the third quarter of the year a period in which the growth in exports began to be affected by the unsettled international monetary scene and the prolonged United States West Coast strike. Over all, the balance of payments in the first nine months of 1971 showed a surplus of US\$22.8 million compared with US\$1.0 million in the same period of 1970.

The floating of the peso on 20 February led to its *de facto* devaluation from 3.9195 (interbank rate) to one US dollar to 6.195 pesos in June and 6.435 pesos in October 1970. The rate remained firm at this level through the first half of 1971.

The improvement in the over-all balance of payments, together with Central Bank foreign loan operations, has been reflected in an increase in the international reserves of the Central Bank and the foreign exchange holdings of the commercial banks, which rose from US\$125.9 million at the end of 1969 to US\$219.0 million at the end of 1970 and to US\$241.0 million by end of September 1971. The smaller extent of the rise in these reserves during 1971 is mainly due to net loan repayments of US\$1 million

during 1971, compared with net borrowings of US\$79 million for the same period in 1970.

(c) Money supply

In 1971, the policies of monetary and fiscal restraint adopted in 1970 have been continued. With the easing of the external debt problem through restructuring and the improved balance of payments position, some relaxation in the controls has been permitted by mid-1971, such as removal of the previously required Central Bank approval of machinery imports. Money supply has continued to grow, though the rate of expansion has fallen.

It rose sharply at the end of 1969 but remained fairly stable through most of 1970. However, a further sharp rise occurred in December 1970, and, with an increase of 3.0 per cent in the first half of 1971, brought the total expansion for the year ended June 1971 to 15.6 per cent by comparison with a rise of 18.2 per cent in the preceding 12 months. In 1969 the major source of increase of money supply was public borrowings, while the external sector was a contractionary force, but in 1970 the roles were reversed: the external sector has had an expansionary impact because of the mild boom in exports, the private sector has been moderately expansionary, and the public sector has exercised a contractionary influence.

In the first six months of 1971, the public sector has continued to do so but the external sector and the private sector have been expansionary. In September-October 1971, therefore, the Central Bank tried to dampen monetary and import expansion by imposing margin requirements (cash deposits) for letters of credit. These requirements were to reach a level of 30 per cent by the end of October 1971.

(d) Prices and wages

The monetary expansion, coupled with the pressure on costs because of higher import prices in the wake of the *de facto* devaluation of the peso, has resulted in rising prices. In 1969, the consumer price index for Manila rose by 1.5 per cent, while in 1970 it rose much more sharply by 8.3 per cent, and in 1971 by a further 19.8 per cent. In July 1971, with the expiration of a price control law (which was subsequently renewed), prices jumped by a further 5.1 per cent. Money wage rates have also risen but not as fast as prices and thus real wage rates, especially for skilled labourers, have declined through most of 1969, 1970 and the first half of 1971. Movements in money and real wage rates for skilled and

unskilled labourers over this period are shown in the following table:

Table II-3-25. THE PHILIPPINES: AVERAGE DAILY REAL AND MONEY WAGE RATES, 1969-1971^a

(1955 = 100)

	Money wage rates		Real wage rates	
	Skilled	Unskilled	Skilled	Unskilled
1969	143.0	160.3	89.2	100.0
1970	151.9	177.9	80.9	94.5
1971 (1st half) . .	158.5	191.4	74.9	90.4

Sources: (1) *Central Bank of the Philippine Statistical Bulletin*, December 1970;

(2) *Central Bank News Digest*, Vol. XXIII, No. 37, 14 September 1971.

^a Labourers in industrial establishments in Manila.

(c) Public finance

The sharp reduction in the cash deficit in the public accounts has been a major contributory factor to the greater degree of economic stability in recent years. Since 1962 every fiscal year has shown a cash deficit, most of which was financed by recourse to Central Bank. In 1969/70, the cash deficit reached 765.9 million pesos. In late 1969 and in the first half of 1970 the effects of fiscal reforms, new taxes and retrenchment policies began to have their effect. In the second half of 1970 there was a net cash surplus of 77.0 million pesos, compared with a net deficit of 857.7 million pesos for the same period in 1969. Further improvement was effected through the first half of 1971 when a cash surplus of 267.6 million pesos was recorded; this may be compared with a surplus of 90.9 million pesos in the first half of 1970.

Problems and prospects

The problems that the economy faces in the immediate future have to do more with external than with internal factors because, in the period since early 1970, it has been shown that domestic economic policy, especially as regards fiscal and monetary management, has been soundly conceived and effectively implemented.

A worrisome factor has been the United States West Coast dock strike as shipments of major Philippine exports — sugar and copper concentrates for instance — have been held up, at a time when the Philippines is anxious to fill its sugar quota on the United States market.

The sugar quota consists of a basic quota of 1,126,020 short tons plus 47.22 per cent of any deficiencies from other suppliers, or 1,520,947 short tons in 1971. But, under the new Sugar Act of 1971, which will be in effect from 1972-1974, the Philippines have been given a lower over-all quota of 1,314,020 short tons. The resultant loss in earnings is estimated at some US\$30 million a year. The expected setback in sugar earnings will come at a time when the outlook for log exports, the largest single category of exports in the last decade, is uncertain on account of the depletion of Philippine forests and competition from Indonesian logs. Prices of copper, the fourth largest export, are down but increased volume has kept export earnings at the same level as in 1970 and further increases in receipts from this product are expected in 1972. For the 1970s, it is expected that current investment in the development of nickel ore will result in a further expansion in export earnings from the mining sector.

The long-run problem now that a greater measure of stability has been attained is to resume the growth momentum. Industrial and agricultural investment in the private sector is reacting favourably to the special incentives offered. More vigorous export promotion is now taking place and the *de facto* devaluation of February 1970 has given a spur to exports, most significantly of manufactured items. The Government has resumed its borrowing, this time for long-term development projects, the highest priority being electric power development.

The process of changing the structure of the Philippines has been going on now since the mid-1950s. Substantial momentum for economic development has been built up, but growth has been set back by events which have led to two *de facto* devaluations within eight years (1962 and 1970). Nevertheless, in the 1950s, the foundations for industrial development were laid, and, in the 1960s, major changes were initiated in the agricultural sector. The recent performance of the economy has persuaded the Philippine authorities that an upward adjustment of development plan targets is justified. Though original targets were modest they had been substantially exceeded in 1970 and 1971. Accordingly, in the new four-year development plan (FY 1972-1975) the planned average annual growth rate has been revised upwards to 6.9 per cent, representing a rise from 6.5 per cent in 1972 to 7.0 per cent in 1975.

Republic of Korea

Introduction

Real GNP increased in 1970 by 9.7 per cent and *per capita* income rose to \$233. Industrial produc-

tion grew by 17.4 per cent and social overhead and capital by 10.2 per cent. Exports and imports increased by 21.9 and 8.2 per cent respectively over 1969. Current indications suggest that, in 1971, the economy will sustain the high growth path of the past.

Table II-3-26. REPUBLIC OF KOREA:
MAJOR ECONOMIC INDICATORS

(Rates of growth per cent at 1965 constant
market prices)

	1969	1970	1971
GNP	15.9	8.9	10.2
Agriculture, forestry and fishery	11.9	-0.8	2.5
Manufacturing	22.3	17.9	19.1
Gross capital formation	31.2	-3.9	5.8
Domestic savings as % of GCF	62.7	64.6	n.a.
Exports	32.0	21.9	20.4
Imports	24.6	8.2	27.3
Wholesale prices ^a	6.8	9.1	7.1
Money supply	44.4	21.9	-2.1

Sources: Bank of Korea and Economic Planning Board.

^a 1969 and 1970 figures calculated on 1965 = 100;
1971 = 100.

Recent economic developments

(a) Growth performance

In 1970, GNP registered a growth rate of 8.9 per cent, far slower than the increase of 15.9 per cent attained in 1969. This slower rate of growth in 1970 is reflected in the sharp decline in the growth rate of several key economic indicators. Gross capital formation increased by 31.2 per cent in 1969 but fell by 3.9 per cent in 1970. Exports and imports rose by 32.0 and 24.6 per cent respectively in 1969, but increased by only 21.9 and 8.2 per cent respectively in 1970. Finally, the absolute level of foreign savings declined by 4.3 per cent in 1970, as compared with 19.2 per cent increase in the previous year. These reduced rates of growth in key economic variables are primarily the result of the Government's successful effort to curb excessive investment and imports demand.

In terms of GNP by sectors of origin, agricultural output grew at only 2.0 per cent in 1970. Non-agricultural activities grew by 12.8 per cent in 1970 as compared with 17.5 per cent in 1969. Within the latter category, the highest growth rate was recorded by manufacturing and mining. The social overhead capital and other services sector achieved an over-all growth rate of 10.2 per cent in 1970, as compared

with 15.6 per cent in 1969. In this sector, the growth rate of social overhead capital slowed down to 9.7 per cent in 1970 from the high growth rate of 28.4 per cent recorded in the previous year.

According to preliminary estimates, GNP in 1971 grew by 10.2 per cent, led by the fast 19.1 per cent growth of the manufacturing industry. The agricultural sector performed poorly with a growth rate of only 2.5 per cent.

(b) Price level

Wholesale prices during 1970 increased by 9.1 per cent. Consumer prices in Seoul rose by 14.2 per cent in 1970 compared with a 10 per cent increase in the previous year because of the sharp increase in food prices and miscellaneous service charges.

The money supply recorded a 21.9 per cent increase during 1970, as against a 44.4 per cent rise in 1969, and the rates of growth in time and savings deposits and domestic credit creation were 37.2 per cent and 32.3 per cent respectively. The pressure on prices was due, in part, to the rise in aggregate demand, and, in part, to the shortage in staple foods such as rice and key raw materials.

(c) Investment and savings

Gross domestic fixed-capital formation, as a percentage of GNP, decreased from 34.5 per cent in 1969 to 28.0 per cent in 1970, while in real terms it declined by 3.9 per cent in 1970 as against a 31.2 per cent increase in 1969. The major factors responsible for this sharp decline were the substantial fall (12.3 per cent) in government investment programmes, and the decrease (11.2 per cent) in demand for plant and equipment investments in the private sector due to tight control over foreign capital inflow and commodity imports and to the imposition of restrictive fiscal and monetary measures. During the first half of 1971, preliminary estimates show that public construction investment rose by 24.6 per cent and investment in plant and equipment rose by 9.7 per cent.

In 1970, 22.2 per cent of all gross domestic fixed-capital formation was in mining and manufacturing, 71 per cent in social overhead capital, and only 6.3 per cent in the agricultural sector. These relative ratios in the composition of capital formation remained unchanged as compared with the previous year.

Domestic savings as a source of finance of fixed capital increased steadily as a proportion of gross investment, from 57.3 per cent in 1969 to 63.5 per cent in 1970. The ratio of foreign savings to gross capital formation of 35.4 per cent emphasizes the

continuing dependence of the economy on foreign capital. Gross domestic savings, as a percentage of GNP, decreased from 17.2 per cent to 16.6 per cent over this period. The composition of foreign savings continued to change, with non-concessionary capital flows increasing by 15.3 per cent and concessionary flows declining by 24.6 per cent.

(d) *Government revenue and expenditure*

Total revenue of the national government for the fiscal year of 1970 was 423.0 billion won and total expenditure was 446.3 billion won, the difference being made up by the receipts from counterpart funds made available through the US assistance programmes. The proportion of government revenue made up by tax receipts increased from 74 per cent in 1969 to 81 per cent in 1970. In terms of growth rates, tax revenue increased by 14.8 per cent in 1970 as against an increase of 20.8 per cent in 1969. Total government revenue excluding the counterpart funds increased only by 5.6 per cent as against an increase of 29.7 per cent in 1969. The proportion of the counterpart funds in the government revenue continued to decrease from 6.8 per cent to 5.3 per cent between these two years. Direct taxes are the major source of tax revenue, constituting about 50 per cent of all tax revenue for the period 1969/70. The remaining tax revenue was made up of indirect taxes (30 per cent) and custom duties (16 per cent).

(e) *Balance of payments and trade*

According to preliminary estimates, the deficit on the current account of the balance of payments, including transfer payments, increased in 1970 to \$601.4 million from \$550.2 million in 1969. The trade balance registered a slightly smaller deficit of \$879.1 million compared with \$991.7 million in 1969, with commodity exports increasing by 34 per cent and commodity imports by 6.8 per cent. Exports of both commodities and services increased by 21.9 per cent and imports of commodities and services went up 8.2 per cent during 1970. During the first half of 1971, total exports are estimated to have increased by 20.4 per cent and total imports by 27.3 per cent over their respective levels in the same period of the previous year.

The export of industrial products increased by 35.3 per cent and the share of industrial products in total commodity exports increased to 78.5 per cent in 1970. Textile products, including clothes and fabrics, were the single biggest earner, amounting to \$300 million, which accounts for about 35 per cent of total commodity export earnings. The export of wigs and plywood earned around \$100 million each in 1970.

Major policy developments

Toward the end of 1969, the Government adopted measures to curb price increases, expansionary investment activities and excessive consumer demand. These measures consisted of restrictions on new loans, deflationary budget operations through an increase in the budget surplus, and other direct measures to control the money supply. During the first half of 1970, stronger stabilization programmes, known as "monetary and fiscal austerity programmes", were enforced. On the monetary side, a 40 per cent limit was placed on the maximum rate of expansion of domestic credit creation; discounting by the Central Bank was suspended; and excessive bank liquidity was absorbed through the issue of government securities. On the fiscal side, the rate of government budgetary expansion was limited to 14.3 per cent for the fiscal year 1970, as against a 44 per cent increase in 1969. In addition, a series of new excise taxes were imposed on consumer durables and luxury items to curb excessive demand.

Direct stabilization measures were also introduced. The target rate of growth in GNP and the level of investment were reduced to arrest overhead investment activities — the major cause of excessive aggregate demand. The target rate of growth of GNP for 1970 was adjusted to 10 per cent, as against the 15.9 per cent growth rate realized in 1969, and the ratio of investment to GNP was reduced to 28 per cent, as against 34.5 per cent in 1969. Residential and commercial construction activities and luxury consumption were restricted through direct controls and taxation. In order to stabilize the prices of major daily necessities and raw materials, the Government supported the supply and stockpiling of these items and adjusted imports through tariff reduction and expanded transportation facilities. A direct price freeze was imposed on public utility charges during the second half of 1970.

The most important policy shift was perhaps the 13 per cent devaluation of the won that was carried out in July 1971. Though the amount of exchange rate alteration required was debatable, the decision on devaluation itself was a step in the right direction toward a more efficient and stable development process. In the general realignment of parities which took place late in 1971, the Republic of Korea maintained parity with the US dollars and devalued in terms of yen.

Concurrently with the won devaluation in June, the Government made a slight downward shift in interest rates as part of a long-range programme to

reduce the country's interest rates which are abnormally high in comparison with other developing countries. The annual interest on savings deposits was lowered by 1.5 per cent from 22.8 per cent to 21.3 per cent, and that on commercial loans was lowered by 2 per cent from 24.0 per cent to 22.0 per cent, thereby increasing the margin from 1.2 per cent to 1.7 per cent. The immediate motive behind the reduction in interest rates was to adopt a more rational structure of rates, to improve bank earnings and to ease the excessive burden of interest costs on business enterprises.

The effect of these stabilization programmes were very much apparent in the over-all slowdown in aggregate demand in 1970. Whereas the stabilization programmes produced immediate effects on output and investment, however, it has had a delayed effect on the price level, as evidenced by the 9.8 per cent increase in wholesale prices as against the 6.7 per cent increase of 1969. Nevertheless, the strong upward pressures on the price level coming from official grain-purchasing prices, increases in excise tax rates and the won devaluation in 1971 must have been offset to some extent by the stabilization programmes pursued throughout the period under review.

Economic outlook

The economic outlook for the balance of 1971, the terminal year of the second plan, and for 1972, the initial year of the third plan, is reflected in the targets of the new plan. By looking at the planned targets for 1971, and judging from the actual performance during the first half of 1971, it is evident that the economy in 1971 will follow the same path of rapid growth as in previous years.

The growth of GNP for 1971 is likely to approximate 11.5 per cent, as against the planned rate of 10 per cent, with *per capita* GNP increasing by 9.6 per cent from \$233.0 in 1970 to \$251.7 in 1971. The growth rate of GNP is projected in the third five-year plan (1972-1976) at 9.5 per cent for 1972, which is much less than the average growth rate of 11.8 per cent achieved during the second half of the 1960s. *Per capita* GNP is scheduled to increase by 7.7 per cent to \$277.3 in 1972. Total consumption in 1972 is planned to increase at 8.6 per cent as against the 10.4 per cent in 1971. While fixed capital investment for 1971 is likely to grow by 16 per cent with the ratio of fixed investment to GNP remaining at 28 per cent, gross fixed investment for 1972 is projected at 8.5 per cent, about one-half of the rate of increase in 1971. All of these planned rates for 1972, as compared with 1971, point to the gradual

shift from the high-growth policy pursued during the second plan period toward a balanced growth policy in the third plan period.

Whereas the agricultural sector is expected to grow at 4.5 per cent in 1972, the non-agricultural sector is projected to grow at 11.7 per cent. Within the latter sector, manufacturing industry is scheduled to maintain a high growth rate of 17.0 per cent in 1972, as compared with the 20 per cent achieved in 1971.

Total exports in 1971 are projected to reach \$1.7 billion, with a target of \$1.35 billion for commodity exports. The corresponding target for 1972 is \$1.58 billion. Total imports are scheduled to grow at the rate of 13.2 per cent from \$2.59 billion in 1971 to \$2.93 billion in 1972 and the deficit in the balance of trade will increase to \$930 million.

There remain a set of problems and bottlenecks to be resolved over the next five years. Among the more important are the relative stagnation in agricultural productivity, leading to ever-increasing import of grains; the rapid increase in real wages; the industrial structure which is becoming more capital-intensive and increasingly dependent on imports; and the ever-widening gap in the balance of payments resulting from rapid growth and continued dependence on a large inflow of foreign capital. A set of new policy measures is called for and these should place greater emphasis on the following: to increase investments in the agricultural sector; to promote the efficiency of resource allocation through correct price signals in terms of wages, interest rates and the foreign exchange rate; to enhance the international competitive power of the Republic of Korea's industries through the strategic choice of appropriate technology and products; and more positive measures for increasing domestic savings.

Republic of Viet-Nam

Introduction

The rate of growth of output in the Republic of Viet-Nam in 1970 has been barely sufficient to match the growth in population. The Republic remains a war-dominated economy with low gross investment. Commodity exports are negligible and imports are financed only by the expenditure of the United States sector in the country and from United States aid receipts.

The most hopeful aspect of the economy is that agricultural productivity will continue to rise.

*Recent economic developments**(a) National income and production*

The gross national product of the Republic of Viet-Nam rose by 2.9 per cent in real terms during 1970. This is a decline from the rate of growth attained in 1969, when there was a sharp rise representing a recovery from 1968.

Agriculture is the predominant sector, constituting about 38 per cent of gross domestic product in 1969. Other sectors are: public administration and defence, 22 per cent; wholesale and retail trade, 12.9 per cent; transportation, 5 per cent; and manufacturing, 4 per cent.

The share of agriculture in output has been increasing and is expected to increase further as a result of various improvements. The agricultural sector provides about 90 per cent of the country's exports in the form of rubber, spices, fish products, tea, coffee, and wood products. The sector also employs about 60 per cent of the total labour force. Rice production accounts for over half of value added in agriculture and uses 86 per cent of the cultivated land.

Agricultural production in 1970 was favourable. Paddy production reached a record level of 5.6 million tons, in spite of floods in November. This represented an increase of 11 per cent over the 1969 output and surpassed the previous record output of 1963. The increase in output is mainly due to the Accelerated Rice Programme, which has extended the use of new high-yielding seed varieties. The Government intends to increase the acreage planted with new seeds by 50 per cent in the 1971 crop year.

Rubber production also increased markedly (by 19 per cent) during 1970, but production remains seriously affected by the damage inflicted on the plantations by war activities and by a shortage of labour caused by military conscription. Livestock and fishery production in 1970 were 10 per cent and 24.5 per cent higher, respectively, than in 1969.

Industrial production is expanding, although the rate of increase has declined. The general index of industrial production rose by 14 per cent in 1970, as compared with 25 per cent in 1969. Some industries, such as paper and paper products, lime and cement, beverages and textiles, increased their output, while the production of others, such as transport equipment, machinery, electrical appliances and aluminium declined.

Construction activities expanded at a reduced pace during the year.

(b) Investment savings and foreign aid

Gross investment is about 10 per cent of GNP. This is low, compared with other countries in south-east Asia. Most public investment has been devoted to construction and rehabilitation, while, in the private sector, most investment has been in machinery and equipment.

One reason why investment has been low is because of the failure to mobilize financial resources. Private savings are still very low, although they have begun to rise recently as a result of the development of commercial banking and a rise in interest rates. The public sector is normally in deficit because of defence and other expenditure requirements. The level of investment which does exist, even though it is low, has been made possible by inflows of foreign aid.

(c) External trade and payments

The balance of trade showed a slight improvement in 1970. While export receipts fell slightly from US\$12.5 million in 1969 to US\$12 million, imports also fell marginally from US\$667 million in 1969 to US\$662 million in 1970. Approximately half of these imports were financed by United States aid and the bulk of the remainder from foreign currency receipts arising from United States expenditure in the Republic of Viet-Nam. There was a slight over-all reduction in the balance of payments deficit, foreign exchange reserves falling by US\$39 million, as compared with a decline in reserves of US\$60 million in 1969.

Exports for 1971 are expected to reach US\$16-17 million, while imports are estimated at about US\$700 million.

(d) Prices and wages

The severe inflation which began early in 1965 has been running at or over 30 per cent per year during the late 1960s, but seems to have moderated since mid-1970. Cost of living increases during the ten-month period from July 1970 to April 1971 appear to have been 10 per cent or less.

The stabilization policies which have reduced the rate of inflation are discussed in the following section.

Policy developments

Stabilization policies initiated by the Government during the third quarter of 1970 and extended

during the first quarter of 1971 included the following measures: a devaluation of the exchange rate which increased the price received for exports from VN\$175 per US dollar to VN\$275 per US dollar in October 1970, and then to VN\$350 per US dollar in June 1971. The effective rate for imports has been consolidated at VN\$400 per US dollar. These exchange rate changes were accompanied by a simplification of the import licensing procedure which extended the range of goods that can be imported. Interest rates have been nearly doubled to encourage private savings. Government revenue has been increased by reducing subsidies and by raising taxes on imports, thereby lessening the need for deficit or inflationary financing. Attempts are also being made to increase budget revenue by improving the tax structure and tax collection. The previous tax system was complicated and cumbersome and resulted in a substantial degree of tax evasion and inequity. An over-all plan to improve the efficiency of tax administration is being finalized.

Prospects

The Government is pushing forward with the Accelerated Rice Programme under which high-yield varieties of seed are being introduced. The intention is not that additional areas should be used for paddy cultivation, but that yields should be substantially increased by the introduction of double cropping in conjunction with the increased use of fertilizers and new seeds. As a result of these improvements the country should again move towards self-sufficiency in rice production. The five-year plan for rural development (1971-1975) envisages that total rice production should increase by 17 per cent in 1971 over the previous year's output. The plan also envisages an increase in production of livestock by 8.7 per cent, of fishery products by 13.9 per cent, and of other agricultural products by 17.2 per cent.

The relative success of the stabilization measures and the more realistic foreign exchange rates should help to provide a climate favourable to the development of the Republic of Viet-Nam's exports and its embryo import substitution industry. Nevertheless, all prospects for the country's economy depend upon the state of the war.

Singapore

Introduction

The Singapore economy in 1970 grew even faster than in 1968 and 1969. *Per capita* gross domestic product in 1970 rose by 11.8 per cent to S\$2,682. However, given the less favourable international situa-

tion in 1971, the likely further fall in entrepot trade and the completed withdrawal of British military bases from Singapore in October 1971, Singapore's growth rate in 1971 is unlikely to reach that of 1970, and, according to Government pronouncements, may be in the region of only 6 to 10 per cent.

Table II-3-27. SINGAPORE:
MAIN ECONOMIC INDICATORS

	1969	1970	1971
Gross domestic product growth rate (% , current prices) . . .	13.7	15.0	10.0 ^a
Exports (S\$ million) . . .	4,741	4,756	2,604 ^b
Imports (S\$ million) . . .	6,244	7,534	4,295 ^b
Money supply (annual change, %) . . .	18.5	15.0	—
Consumer price index (1960 = 100) . . .	111.1	111.5	113.1 ^c
International reserves (commercial banks (net) and official, end of period) (S\$ million) .	3,164.3	3,718.3	—

^a Estimated.

^b First half.

^c End June.

Recent economic development

(a) Economic growth and output

In 1970, the Singapore economy maintained the vigorous pace of expansion exhibited in the previous two years. Gross domestic product in current prices rose by 15.0 per cent, compared with 13.7 per cent in 1969 and 15.3 per cent in 1968. The distribution of this growth by industrial sectors and the proportionate contribution to gross domestic product are shown in table II-3-28.

The most important sectors of the economy are manufacturing, domestic trade and entrepot trade, which together accounted for over half the gross domestic product in 1970. The fastest growing sectors in 1970 were construction, manufacturing and government services. On the other hand, military services' contribution to gross domestic product remained static, while entrepot earnings declined. The indications are that these trends continued in 1971 and may extend into 1972.

With a growth rate of 28.6 per cent, manufacturing accounted for more than one-third of the increase in gross domestic product in 1970. The increasing export-orientation of the manufacturing sector is seen in the rapid growth of manufactured exports; in 1970, direct exports grew by 25.0 per cent,

constituting 42.9 per cent of total manufacturing output, compared with only 27.5 per cent in 1968. Over the past decade the structure of the manufacturing sector has changed significantly. There has been a widening of the industrial base as well as a deepening process, with greater concentration on technologically-sophisticated industries and larger enterprises. The expansion in industrial production has been due in large measure to the growth of petroleum refining, food processing, the manufacture of electrical machinery, apparatus and appliances (mainly electronics component assembly) and shipbuilding and repair.

Table II-3-28. SINGAPORE: GROSS DOMESTIC PRODUCT BY INDUSTRIAL SECTORS 1969/70 — SHARES AND GROWTH RATE
(at current factor cost)

Industrial sector	1969		1970	
	Per cent of total	Growth rate	Per cent of total	Growth rate
Total	100.0	13.7	100.0	15.0
Goods sector	26.1	21.1	28.8	27.0
Agriculture	3.2	4.0	2.9	5.2
Manufacturing	18.5	25.3	20.7	28.6
Construction	4.4	18.4	5.2	36.4
Services	73.9	11.3	71.2	10.7
Electricity, gas, water	2.5	9.8	2.4	13.8
Government services	6.6	6.9	7.1	22.6
Military services	8.3	-11.6	7.3	0.3
Ownership of dwellings	3.8	10.4	3.7	12.1
Tourism	4.7	54.9	4.9	21.0
Wholesale and retail trade	32.0	18.3	30.5	9.5
(a) Entrepot trade	(13.8)	(23.6)	(11.4)	(-4.5)
(b) Domestic trade	(18.2)	(14.5)	(19.1)	(20.1)
Other services	16.0	6.6	15.3	9.8

Source: Statistics Department, Singapore.

The construction sector showed the largest rate of growth in 1970 in response to rising demand for residential housing, office and factory space, shopping centres and hotel accommodation. However, this has given rise to sharp increases in costs and a serious shortage of labour, though these have been offset to some extent by increased imports of construction materials and liberalized immigration requirements for construction workers.

In the services sector, the decline in entrepot trade is in marked contrast to the high rate of growth in 1968 and 1969. The poor performance in 1970 and also in 1971, after the rapid recovery since 1965

with the resumption of trading relations with Indonesia, is due to a number of factors, including the continued low price of rubber, reduced exports of petroleum and petroleum products to the Republic of Viet-Nam, and the increasing direct exports and imports of neighbouring countries. The likelihood is that entrepot trade will in the future continue to fall in relative importance.

Growth in government services in 1970 reflected the increasing importance of domestic defence expenditure in contrast to declining foreign military expenditure which, with the withdrawal of British military forces, will largely disappear.

The high rate of growth in tourism of 1969 was not maintained in 1970 but at 21.0 per cent it was still one of the fastest growing sectors. A slower rate of growth is expected in 1971, and, with the expansion in hotel construction in recent years, surplus accommodation capacity has emerged.

(b) Gross domestic expenditure

Gross domestic expenditure at current prices rose by 19.4 per cent in 1970, as compared with 12.8 per cent in 1969. The year saw gross domestic capital formation rise by 40.9 per cent, reaching 24.5 per cent of GDE, with the largest investments being in machinery and equipment, leading to a rapid growth in productive capacity. A significant percentage of this increase was due to the increase in foreign investment in the private sector. Government consumption expenditure grew by 34.8 per cent for the year, whereas private consumption grew by only 10.3 per cent. With the large number of investment projects both in the public and private sectors still in the process of completion, it seems likely that the rapid rate of capital formation in 1970 will be more or less maintained in 1971.

(c) Employment

Employment increased by 44,300 workers between 1969 and 1970, more than half of which were absorbed in the manufacturing sector alone.

The high unemployment rate of 9.1 per cent recorded in 1966 has been greatly reduced in recent years and there are signs of an increasingly tight labour market. Employers in many areas are finding it difficult to recruit new workers and there is strong competition for skilled labour. As a result, immigration restrictions on non-citizen workers have been relaxed for many types of skills. The number of persons registered at the national employment exchange declined from the peak of 72,300 in 1967 to 43,700 by the end of 1970; by mid-1971 the number

had further declined to 38,000. The trend is expected to continue despite the retrenchment of workers from the British military base.

(d) *External trade and payments*

Exports in 1970 showed a very sluggish growth rate of only 0.3 per cent to reach S\$4,755.8 million, as compared with an increase of 21.8 per cent in 1969. Imports for the same period were S\$7,533.8 million, an increase of 20.7 per cent compared with 22.8 per cent in 1969. For the first half of 1971 exports showed an increase of 12.5 per cent and imports 20.1 per cent over the corresponding period in 1970. As a result of differential growth rates, the trade deficit widened from S\$1,502.9 million in 1969 to S\$2,778.0 million in 1970 and for the first half of 1971 the trade gap stood at S\$1,589.3 million. This growing deficit has been financed by earnings on service account, unrecorded export earnings, unrequited transfers and capital inflows. The buoyancy in imports is largely attributable to the high rate of capital formation and the sluggish growth of exports was due to the stagnating entrepot trade. Domestic exports have shown rapid growth, accounting in 1970 for 45 per cent of total exports.

However, net goods and services account show an increased deficit in 1970, reaching S\$1,881.0 million, as against S\$660.3 million in 1969, but the actual deficit may be very much less, since the errors and omissions in 1970 reached S\$1,922.0 million. The net inflow of private and public capital in 1970 was S\$443.9 million, as against S\$170.2 million in 1969. A substantial over-all surplus was thus achieved and external reserves rose from S\$3,164.3 million at the end of 1969 to S\$3,718.3 million at the end of 1970.

(e) *Money supply and prices*

The money supply increased by 15.0 per cent in 1970. Demand deposits, which formed more than half the money supply, grew by 15.0 per cent. Demand deposits for the first half of 1971 showed a 13.8 per cent increase.

The economy continued to enjoy remarkable price stability. The official consumer price index with 1960 as base shows an increase of only 0.4 points, from 111.1 in 1969 to 111.5 in 1970, and to 113.1 in mid-1971.

(f) *Public finance*

Government current expenditure for the 1970/71 fiscal year ending in March was 18.1 per cent higher than in 1969/70, with internal security, defence and economic services all showing significant increases.

Development expenditure (including loans to statutory authorities) rose by 33.9 per cent, and was financed by a surplus in the current budget, internal loans and use of reserves.

For fiscal year 1971/72, total current expenditure provisions show a 25.5 per cent increase, mainly for defence, though there is provision also for a modest increase in education, health and other social services. Increased revenue provisions for the budget are similarly made without any additional taxes or increase in existing taxes, but rather from the expected normal expansion of economic activity. Estimates of development expenditure for the year show an increase of about 80 per cent. This expenditure is to be financed from the revenue surplus, internal and external loans, and the drawing down of cash balances.

Policy problems and prospects

The major concern in 1970/71 has been the acceleration in the growth of selected sectors to counter the contractionary effects of British military withdrawal and declining entrepot trade. Besides attempts at modernization in all sectors, the regulation and development of monetary and financial institutions to ensure stable and rapid growth, and the problem of environmental pollution, have also received considerable attention.

The major growth sectors in the foreseeable future will continue to be manufacturing, construction, tourism and finance. Priority has been given to industrialization and the Government's encouragement of foreign investment, particularly of technologically-sophisticated export-oriented industries has been highly successful. The industrialization programme has reached a stage whereby it is possible to move away from industries which had been set up for purely short-term considerations and to phase out industries which were established under the conditions of serious unemployment that existed before 1968 and operate on a cheap-labour, low-productivity basis. Industrial incentives are now more selective; and there is increasing emphasis on the training and provision of skilled labour for industries.

On the financial side, legislation has been enacted to provide for a transition to a central banking system and for greater control and orderly development of the banking system and the capital and money market. While the authority for the issue of currency remains with the Currency Board, all other central banking functions have been centralized in the newly created Monetary Authority of Singapore.

In addition, other measures, such as the establishment of a numbered accounts system, have been taken to increase the attractiveness of Singapore as a financial centre.

The prospects for 1971 and 1972 are for a somewhat lower rate of growth than the 1968-1970 period. The full impact of the British withdrawal has still to be felt, though the Government hopes to offset this by an accelerated public sector building programme and increased promotion of private investment. A further adverse factor is the expected continuing decline in entrepot trade earnings. Tourism in the immediate future is expected to grow but not very rapidly, while oil exploration activities in southeast Asia using Singapore as a base of operation has probably reached a peak and is unlikely to be an important new stimulus to growth as it was in 1970 and 1971.

On the industrialization front, however, prospects remain bright. The large manufacturing projects in the pipeline, when they come to fruition, will add substantially to employment, income and export earnings. Singapore is likely to continue to be an attractive place for investors in the region seeking investment opportunities. The crucial factor in the coming years is to ensure that inflationary pressures that will come under conditions of full employment will not lead to an escalation in wage costs without at least parallel, if not larger, improvements in labour productivity. There are also problems such as high land values, the need for a mass transport system and a shortage of professional skills that have to be overcome.

Thailand

Introduction

During the last few years, Thailand has been confronted with several economic problems which have been reflected in a sharp decline in the real growth rate of GDP from 9.6 per cent in 1969 to 6.0 per cent in 1970 and 6.1 per cent in 1971 according to preliminary estimates. A major casual factor of this decline has been the stagnation in exports since 1967, due mainly to the decreased demand for Thailand's rice and to the decline in export prices of rice, rubber and tin. The export growth rate dropped to 1.2 per cent during 1967-1970, from an average of 7.6 per cent during 1960-1967 and the trade deficit increased sharply from about 59 per cent of exports of goods in 1967 to about 86 per cent in 1970. The basic balance of payments which, since the early 1950s, recorded a surplus as a result of substantial capital inflow, has been in deficit since 1969 and

foreign exchange reserves fell by about US\$44 million and US\$128 million in 1969 and 1970 respectively.

Compounding these external difficulties has been the large increase in government current expenditure, in particular on defence, which rose to account for about 17.5 per cent of total government expenditure in 1970. To increase government revenue needed to cover development and current expenditure, a package of tax increases was introduced in July 1970, including increases in import duties, business taxes, and excise taxes. Whereas these measures have resulted in a slowing down of imports, public revenue has not responded significantly and the measures have also tended to affect adversely business confidence.

Table II-3-29. THAILAND: MAJOR
ECONOMIC INDICATORS

(in thousand million baht)

	1969	1970 ^a	1971 ^b
GDP at current prices	130.6	135.3	145.7 ^c
Real growth rate	9.6	6.0	6.1 ^c
Commodity exports	14.3	14.3	15.8
Commodity export growth rate (%)	7.9	—	11.1
Commodity imports	25.4	26.4	26.2
Commodity import growth rate (%)	7.5	3.9	-0.8
Money supply (growth rate)	4.1	8.1	7.6 ^d
Consumers' price index	113.6	113.5	113.3 ^d

Source: Bank of Thailand.

^a Preliminary.

^b Estimated.

^c Estimate of the Office of the National Economic Development Board, the Third Five-Year Plan.

^d Estimate on basis of first eight months.

Recent economic development

(a) Production¹

The growth of agricultural production dropped sharply from 10.1 per cent in 1969 to a mere 2.9 per cent in 1970, but is expected to rise to 6.0 per cent in 1971. The share of agricultural production in GDP has fallen from 30.9 per cent in 1969 to 29.5 per cent in 1971. Contributing to the over-all decline in agricultural production was a sharp decline in crop production from 9.5 per cent in 1969 to 2.2 per cent in 1970, livestock 2.6 per cent to 0.8 per cent and fisheries 29.2 per cent to 8.9 per cent. For 1971, it is expected that the production of rubber

¹ NEDB; 1970 figures are preliminary while 1971 figures are taken from the third plan (1971/72-1975/76).

and maize will increase by 9 and 7 per cent respectively, while tobacco and sugarcane are expected to rise even more sharply in line with buoyant world market conditions.

Although the growth of manufacturing dropped from 10.6 per cent to about 7.4 per cent in 1970, its contribution to GDP rose slightly and is expected to reach 16.9 per cent in 1971. However, partly as a result of the generally depressed condition of the economy, foreign capital registered under the Industrial Promotion Act fell sharply in 1970 to about 23 per cent below its 1969 level and estimates for the first nine months of 1971 indicate a likely further drop of over 37 per cent for 1971.²

The growth rate of mining and quarrying production continued its declining trend, falling from 7.4 per cent in 1969 to 3.8 per cent in 1970; however, it is expected that production will increase by about 5.8 per cent in 1971 due to the sharp increase in output of fluorite, lead, iron and wolfram. Tin, the most important mining product, accounting for about 36 per cent of total mining production in 1969, is expected to grow by only 1.4 per cent in 1971.

Other sectors whose growth slowed sharply in 1971 are construction, electricity and water supply, wholesale and retail trade, banking, insurance and real estate.

(b) Foreign trade and payments

In 1970, Thailand's trade deficit increased from 11.3 to 12.3 billion baht, the deficit rising to a level which was equivalent to 86 per cent of export earnings. The reason for the growing deficit was the stagnation of export receipts in face of continually growing import payments. However, the growth of imports also dropped sharply in 1970 in response to the slower growth in GDP and a variety of policy measures introduced by the Government with a view to curbing imports and promoting exports. The continuing influence of these factors can be seen in the evidence available for the first nine months of 1971. During this period, exports have risen by about 11 per cent, whereas imports have declined by about 3 per cent.

As a result of the improvements in the trade balance, the drain in the country's foreign exchange reserves has been reduced in 1971. The decline in foreign reserves which amounted to 2.6 billion baht in 1970, as compared with 0.9 billion baht in 1969, is estimated to amount to 0.8 billion baht in 1971.

(c) Public finance

The budget deficit rose sharply in 1970, due mainly to the slowdown in government revenue. The deficit, as a proportion of government revenue almost doubled to reach 33.7 per cent in 1970 (table II-3-30).

Table II-3-30. THAILAND: PUBLIC FINANCE
(in billion baht)

	1969	1970
<i>Government revenue and expenditure</i>		
(1) Government revenue . . .	18.3 (8.5)	18.8 (2.6)
(2) Direct taxes as % of (1) . .	11.1	11.7
(3) Government expenditure . .	21.7 (11.4)	25.1 (15.8)
(4) Deficit financing [% of (1)] .	18.5	33.7
<i>Financing of deficit (% of deficit)</i>		
(1) Net external debt	-6.5	-1.2
(2) Net borrowing from Central Bank	132.8	55.9
(3) Net borrowing from public . .	20.9	18.0
(4) Net use of treasury cash balance ^a	-47.2	27.3

Source: Bank of Thailand, *Monthly Bulletin*, December, 1971.

Note: Figures in brackets are growth rates.

^a Including coin issue and changes in non-budgetary account balances.

Compounding the problem of a growing budget deficit has been the shift to bank credit for deficit finance. Whereas, in 1968, borrowing from the public covered 59 per cent of the total deficit, this proportion fell to only 18 per cent in 1970, matched by a corresponding increase in borrowing from the Bank of Thailand and the use of treasury cash balances. These developments may create undesirable excess demand pressures in the economy and to reduce the deficit it would seem advisable to seek ways of increasing government revenue, without at the same time making the low-income groups worse off. In this connexion, it is important to note that only about 11 per cent of government revenue comes from direct taxes, the vast majority being raised by indirect taxes. With this tax structure it is likely that the low-income earners will be the most adversely affected by any attempt to raise taxes which does not alter the basic tax structure.

(d) Money supply and prices

Whereas before 1969 net foreign assets contributed greatly to the expansion of the money supply, with net claims on government and private sectors only slightly affecting the expansion, this situation has now been reversed. Recently, net claims on

² Office of Board of Investment.

government have increased sharply, but the run-down of foreign reserves has partly offset the expansion in the money supply. In fact, the growth in the money supply on a net basis has dropped well below the 1968 figure of 10 per cent to 4.1 and 8.1 per cent in 1969 and 1970 respectively, although preliminary figures for 1971 indicate a growth in the money supply of 7.6 per cent. As regards the general price level, the consumer price index has remained fairly stable over the last two years.

Policy issue and economic outlook

In an attempt to improve Thailand's economic performance, attention could be paid to: (i) production and export promotion, particularly in agriculture and manufacturing as the mainspring for growth, and (ii) the improvement in efficiency that can come about through better plan formulation and implementation and pricing policies.

The production and export of agricultural produce could be greatly increased by better co-ordination among various agencies in both the private and public sectors by using programmes which specify clearly the responsibilities and phasing of operations of all agencies involved. To increase production and exports of manufactured goods, industrial estates and free trade industrial zones ought to be established.

To stimulate growth it might be advisable to review the existing tax structure and to reform this in line with a new set of objectives with the priorities listed as follows: (i) to help increase domestic production, (ii) to help curb the drain of foreign exchange reserves, (iii) to improve social justice, (iv) to increase government revenue.

The third five-year plan came into effect in 1971 and this sets a target for real GDP growth at 7.0 per cent per year as part of a programme which attempts to revitalize the economy. Other objectives include external and internal economic stability, regional development, and a curtailment of population growth and unemployment. Quite a number of projects were designed to attain these objectives, but the plan does not contain adequate co-ordination among projects or consistent phasing of these projects over the plan period.

To improve the prospects for development, it seems necessary that the development plan should be made more operational by containing well co-ordinated programmes that comply with the over-all plan objectives, instead of having only a large number of independent projects. The programmes should specify clearly the responsibilities of the agencies

involved as well as the related phasing of all operations of the various projects. Improvements in the process of following up the success of plan implementation as well as appropriate progress evaluation according to the phasing specified in the plan would also seem to be necessary.

If policy measures along these lines were adopted, it may well be possible that, after a period of adjustment, the economy would grow at rates high enough to ensure the attainment of the targets specified in the plan.

Tonga¹

Introduction

Tonga is faced with declining export receipts because of the fall in banana exports. However, although the adverse trade balance increased in 1970, official foreign exchange reserves continued to improve because of capital inflows. Measures have been taken recently to reverse the downward trend in banana exports but it is still too early to assess their impact. A substantial portion of the capital inflows in 1969/70 consisted of private transfers and the policy emphasis of the second development plan may lead to a strengthening of private capital inflows in the immediate future.

Expansionary fiscal policy recently has led to increased domestic demand and imports. The price level has remained relatively stable, however, because of the existence of price control.

Recent economic developments

Towards the end of 1969, contraction in the traditional export sector and in government expenditure combined to generate a downward adjustment in demand and output. Total export earnings² and total government expenditure decreased by 12 per cent and 6 per cent respectively from their highest level in the decade of T\$3,846,300 and T\$3,166,400 respectively in 1968. The contraction in the traditional export sector was caused mainly by the presence of banana diseases which seriously affected banana production. Banana exports dropped by 61 per cent from their unprecedented high level of T\$1,739,000 at the end of 1968 to a mere T\$684,000 in 1969.

¹ This is the first time that a survey of Tonga has been included in the Economic Outlook Section of the *Economic Survey of Asia and the Far East*.

The Kingdom of Tonga (or the Friendly Islands) consists of a group of some 150 islands with a total land area of 269 square miles scattered over 20,000 square miles of the South Pacific.

² Over 90 per cent comes from copra and banana exports.

Table II-3-31. TONGA: MAIN ECONOMIC INDICATORS

(in thousand Tongan dollars)

	1968	1969	1970	1971
Gross domestic product ^a	—	—	9,635 ^b	—
Exports (per cent per annum change)	7.8	-11.6	-20.7	—
Imports (per cent per annum change)	-10.1	-1.2	8.9	—
Trade balance	-1,304.1	-1,688.8	-2,863.0	—
Overseas funds ^a	793.4	872.4	—	—
Consumer's price index (September quarter = 100)	—	101.1	101.0	101.9 ^c
Population (thousand)	82.2	84.8	87.3	89.9

Source: Kingdom of Tonga, *Statistical Abstract 1971*, Statistics Office.^a Refers to fiscal year ended 30 June.^b Underestimated. No allowance has been made for subsistence output from the fishery sector, an important activity in the life of the average Tongan family. Compiled for the fiscal year 1969/70 by the Statistics Office after its establishment in 1971.^c Average of March and June quarters.

Although the loss from banana export earnings was partly compensated for by higher receipts from copra exports, the impact of the damage done by the banana diseases led to a trade deficit of T\$1,688,800 in 1969.

Towards the end of 1970 and during the first half of 1971, despite a further decline in exports by nearly 21 per cent to T\$2,676,400 because of lower banana exports in 1970, expansionary fiscal policies led to an upturn in economic activity. Government current expenditure rose by 21 per cent over its 1968/69 level to T\$2,629,000 for the fiscal year ended June 1970. The estimate for total government expenditure, both current and capital, for the fiscal year 1970/71 was a further increase of 36 per cent to T\$4,582,300. Current expenditure was financed mainly by custom duties, which amounted to about 40 per cent of total current revenue of T\$2,714,000 in the fiscal year 1969/70. Development expenditure in 1969/70 was T\$748,600, 75 per cent of which was financed from external sources, mainly grants from the United Kingdom Colonial Development and Welfare Funds. These grants in the fiscal year 1970/71 were expected to fall to T\$445,000, only 31 per cent of the estimated development expenditure of T\$1,428,400, though expected to rise to 74 per cent in 1971/72.

Total public expenditure for the fiscal year 1971/72 is estimated to be T\$4,539,400, similar to the estimated budget provisions for the year 1970/71.

The recovery in domestic incomes and demand during 1970 was reflected in a rise in imports and also in the growth of household savings and business

deposits with the Banking Division of the Treasury.³ Total deposits increased by 31 per cent to T\$713,000 at the end of 1970, and, between January and December 1970, imports rose by 9 per cent from T\$5,087,500 to T\$5,539,400.

Available statistics indicate a slowing down in the rate of population growth. At the end of the 1970s, the annual increase in population was down from over 3 per cent to 2.9 per cent. The gross domestic product for the Kingdom for the year ended June 1970 was estimated at T\$9,635,300 and the *per capita* income was approximately US\$130. With the slowdown in population growth, coupled with the recovery of income towards the end of 1970, the net result appeared to be an improvement in *per capita* income.

Policies and prospects

Fiscal policy was the main stimulus to the resumption of growth towards the end of the 1970s. The accelerated increases in the rate of government expenditure during 1970 and the first half of 1971 were the result of a revision of civil service salaries as well as the implementation of the Kingdom's second five-year development plan (1970-1975).

An important aim of the first plan (1965-1970) was to improve export performance by means of an expansion of copra and banana production through

³ Agricultural production and retailing activities dominate the private sector of the economy.

the provision of a coconut replanting scheme, free fertilizers and agriculture extension services. Other important aims were the increase in production for local consumption of pigs and cattle through subsidy schemes and the promotion of tourism and fisheries.

The plan also provided for infrastructure development, such as the improvement of facilities for the marketing of agricultural produce and increased expenditure on education, health and family planning programme. One problem of the first plan was the lack of proper balance between projects of short- and long-term gestation. This led, during the year 1965-1970, to a raising of internal demand with little corresponding increase in output.⁴

The Kingdom's second development plan continues the broad policy mix of the first plan but with more stress on the diversification of the international sector of the economy. In this regard, particular emphasis is placed on the role of the private sector in the development process. Foreign investment policy announced prior to 1970 is aimed at encouraging overseas companies to establish import substitution or export-oriented industries in certain sectors of the economy. These industries relate to preservation of fruits, vegetables and agricultural produce, the further expansion of fishery production, and the development of the clothing, footwear, handicrafts and tourist industries. A great deal of interest was shown by the response of a large number of overseas companies, and several projects have been approved.

To guide and co-ordinate the development of the tourist industry, a Tourist Office was set up in 1970. A major responsibility of the office was the systematic development of tourist resorts throughout the Kingdom and also the promotion of tourism abroad. To aid the developmental and policy-making role of the Government, a Statistics Office was also established in 1971. The establishment of this office was motivated by the realization that the success of economic policy depended on adequate information on the actual functioning of the Tongan economy and on the inter-relationships between the economic and non-economic factors. Credit unions were introduced during 1970 to encourage and mobilize small savings. Co-operative societies have been encouraged to organize small-scale production in handicrafts and in agriculture.

The main problem which may hamper growth in the immediate future is the possibility of further deterioration in the external trade balance, and its consequential deflationary impact on the economy.

On the assumption that the upward trend in copra exports will continue into 1972 and that the decline in banana exports is successfully reversed, the outlook for 1972 appears promising. Public expenditure will be maintained at a high level. The upward trend in tourism is likely to continue in 1972 and the impact of the expenditure incurred by foreign companies approved for operation in the Kingdom, such as the oil search started in October 1971 and hotel building, will reinforce the expansionary impact of the authorities' stimulatory fiscal policy.

On the above assumptions, economic activity will significantly increase. Because of the close dependence of imports on the level of domestic incomes, a policy to slow down the growth in imports of consumption goods seems desirable.

Western Samoa

Introduction

In 1970, Western Samoa's gross domestic product in real terms, excluding subsistence output, is estimated to have grown by 2.8 per cent. In the face of rapid population growth, *per capita* GDP was stagnant. The economy, however, showed a degree of resilience in overcoming the serious fall in export earnings from 4.63 million talas¹ in 1969 to Ts 3.39 million in 1970. A major factor accounting for this was the increased level of activity in the government sector. Total government expenditure grew by 23 per cent from Ts 6.1 million in 1969 to Ts 7.5 million in 1970. Growing amounts of capital inflow, both private and public, ensured a strong surplus in the balance of payments capital account, so that the country's foreign exchange reserves rose again in 1970. A major landmark was achieved in 1970 when the second five-year plan (1971-1975) was introduced. The major goals envisaged in the plan are the diversification of agriculture and the development of secondary industries and infrastructure.

Recent economic developments

(a) National income

Provisional, unofficial estimates of Western Samoa's gross domestic product at factor cost and by sector of origin for 1969 and 1970 are shown in table II-3-32. For 1970, gross domestic product on a *per capita* basis totalled Ts 110. To this has to be added subsistence output, provisionally estimated at

⁴ During the first plan period, selective import control was imposed due to the impact of the 1961 hurricane, but this has been gradually liberalized since 1967.

¹ One tala, during the period under discussion, was equal to US\$ 1.40. The form used in these pages will be "Ts" followed by the appropriate numerals.

Ts 50 *per capita*. When account is taken of a net inflow of overseas income of about Ts 1.2 million and other adjustments such as subsidies, transfer income and indirect taxes, it can reasonably be assumed that *per capita* levels of GNP at market prices, inclusive of subsistence income, are of the order of Ts 180.

Table II-3-32. WESTERN SAMOA: GROSS DOMESTIC PRODUCT AT FACTOR COST

(in thousand talas)

	1969	1970
Agriculture	3,157.1	2,716.6
Commercial services	7,935.0	8,583.7
Manufacturing	535.9	614.8
Tourism	187.4	246.6
Government	2,723.2	3,147.7
Missions	1,020.0	1,048.1
Total	15,558.6	16,357.5

The rise of 5.1 per cent in gross domestic product (at current prices) during 1970 was due to an increased level of activity in the government and transport sectors, building, manufacturing and tourism. Income originating directly from agriculture fell by 14 per cent, with cocoa showing the most dramatic decline. In real terms, *per capita* GDP appears to have remained constant in the face of a rise of 2.3 per cent in consumer prices and estimated population growth of 2.8 per cent. However, over-all *per capita* income probably declined, as subsistence production needs to be taken into account, and there are grounds for believing that this component of production has not been marching in step with population increase.

(b) *Foreign trade and the balance of payments*

Since exports make up such a large proportion of GDP,² the sharp set-back in Western Samoa's exports was undoubtedly the dominant economic event in 1970, a situation which is being reversed in the current year. Exports slumped from Ts 4.6 million in 1969 to Ts 3.4 million in 1970. The value of the three traditional exports, which usually account for around 90 per cent of total exports, fell by 30 per cent; copra and cocoa were mainly responsible for this sharp decline, as receipts from bananas decreased only marginally. For all three commodities, a reduction in the volume exported was a major cause of the decline in the value of exports.

² Estimated at about 30 per cent in 1969.

In 1970, imports rose substantially from Ts 7.3 million to Ts 9.8 million, and they appear likely to remain at about this level in 1971. The strong rise in imports contrasted with the drop in exports and gave rise to a record trade deficit of Ts 6.2 million. Significant increases were registered by the major components of imports, particularly of capital goods items. The sharp rise in imports of machinery and transport equipment reflected the commencement of a number of major projects which have large import content. The latest complete estimates of the country's balance of payments for the first half of 1970 shown in table II-3-33, reveal a substantial deficit on current account. According to the Bank of Western Samoa, there was a surplus over the whole year of Ts 100,000 on current account, mainly attributable to a strong rise in private transfers. With a continued strengthening of the capital account, due, in part, to capital flows associated with the projects mentioned above, the final outcome for the year showed a further consolidation of the country's foreign reserve position.

Table II-3-33. WESTERN SAMOA: BALANCE OF PAYMENTS 1969-1970

(in thousand talas)

	1969	1970 (first half)
Current		
Exports (f.o.b.)	4,830	1,890
Imports (c.d.v.)	7,394	4,666
Net balance of trade	-2,544	-2,776
Net balance on invisibles	2,044	626
Balance on current account	-500	-2,150
Capital account		
Private	532	1,049
Government	257	525
Foreign notes and coins repatriation	529	257
Net borrowing or repayment to Western Samoa	624	1,055
Net change in foreign reserves	-1,444	-759
Errors and omissions	2	23
Balance on capital account	500	2,150

Source: Department of Economic Development, Apia, Western Samoa.

(c) *Public finance*

Despite a fall in the proceeds from export taxes, revenue on current account grew by just over 11 per cent in 1970 to Ts 6.9 million; and, with the

recovery of exports now under way, official revenue from tax and related sources is expected to rise substantially in 1971. However, total public expenditure grew more rapidly from Ts 1.1 million in 1969 to Ts 7.1 million in 1970. Consequently, there was increasing recourse to borrowing, mainly from external sources.

For 1971, estimated receipts from ordinary revenue are expected to rise to Ts 7.3 million, but total government spending is estimated to reach Ts 9.7 million, implying that the gap to be filled from other sources will have more than doubled. A major factor accounting for the growth in public spending in 1970 has been the substantial increase in expenditure on public works, education and health. Outlay on categories other than expenditure under the five-year plan accounted for 52 per cent of the total in 1970.

(d) *Banking*

The activities of the Bank of Western Samoa — the country's sole banking institution — rose strongly in 1970. Financial commitments relating to imports accounted for a large proportion of the increase in bank lending, although a policy of restraint continued to apply to lending in other areas.

Policy changes and other developments

In 1970, the Government introduced the second five-year development plan, covering the period 1971-1975. The major goals that it sets forth are a rise in standards of living, agricultural diversification and improvements of agricultural productivity, development of secondary industries and more efficient utilization of capital and labour resources. Recognition of the need to give priorities to agriculture, especially at the village level, and to economic infrastructure, is clearly evident in the plan.

To attain its objectives, the plan provides for an outlay of Ts 48 million during the period, of which Ts 32 million is committed to current operation expenses and Ts 15.8 million to development projects. About Ts 37 million of the proposed expenditure is to be raised from ordinary revenue sources; the balance, from domestic and external loans. A national provident fund which is about to be established will assist in mobilizing domestic financial resources. Furthermore, the Bank of Western Samoa's Development Department, an embryonic development bank

administered on behalf of the Government, was re-organized and expanded in 1970, and further funds were made available for lending specifically to the agricultural sector.

In the field of manufacturing, new enterprises were established in 1970 and 1971 in such areas as engineering, the production of desiccated coconut and the manufacture of sandals. The momentum to industrial growth generated in the mid-1960s, when the Enterprise Incentives Act was introduced, was therefore maintained, but it has become increasingly apparent that there is need for greater discrimination in the selection of industries on which to confer benefits under the Act.

Outlook for 1971/72

Provided current trends continue throughout the year, the volume of total exports for 1971 should be well above that for 1970, though below the 1969 level. Making some allowance for the sharp fall in copra prices since August, and for the likely level of other exports, the total value of exports for the year is estimated at Ts 4.3 million, or 26.7 per cent above the 1970 level. If imports are of the likely order of Ts 9.8 million, the trade deficit for 1971 will fall to Ts 0.7 million below that of 1970. With the likelihood of a substantial increase in the number of tourists, and a high level of activity in the field of construction, it is expected that the rise in national income will be equal to, or slightly above, the 5 per cent increase recorded for 1970.

For 1972, there are good reasons for optimism. Though much depends on such factors as prices, weather and shipping, Western Samoa can look forward to a further rise in the value of its total exports in 1972. Further impetus to the economy can be expected from the rapid expansion in tourism, now the country's major foreign exchange earner next to copra. Two other favourable factors are a buoyant activity in construction in response to rising building demands, particularly on the part of the Government, and the continuing injection of comparatively large amounts of private remittances from overseas. On the other hand, the Government is alert to the possibility of certain problems stemming from its greatly expanded development programme under the second five-year plan, such as the threat of inflationary pressures and shortages of trained manpower.

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